BUILDING SUCCESS

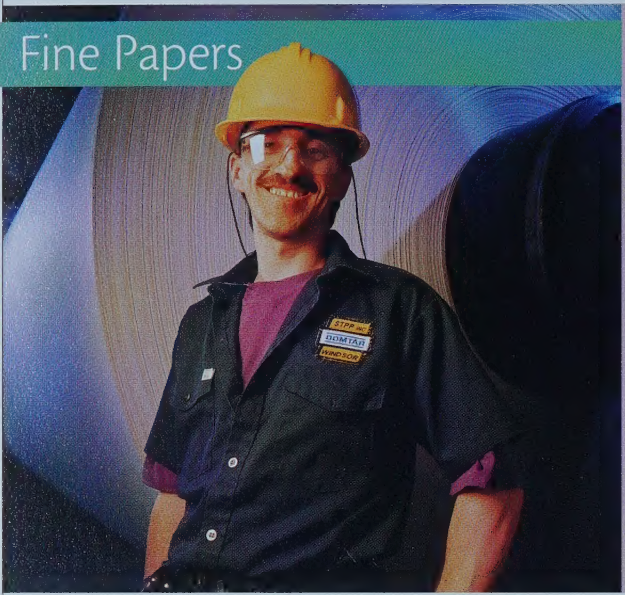
FOR THE CORPORATION

ANNUAL REPORT 1997

CUSTOMERS SHAREHOLDERS EMPLOYEES

DOMTAR®

Fine Papers



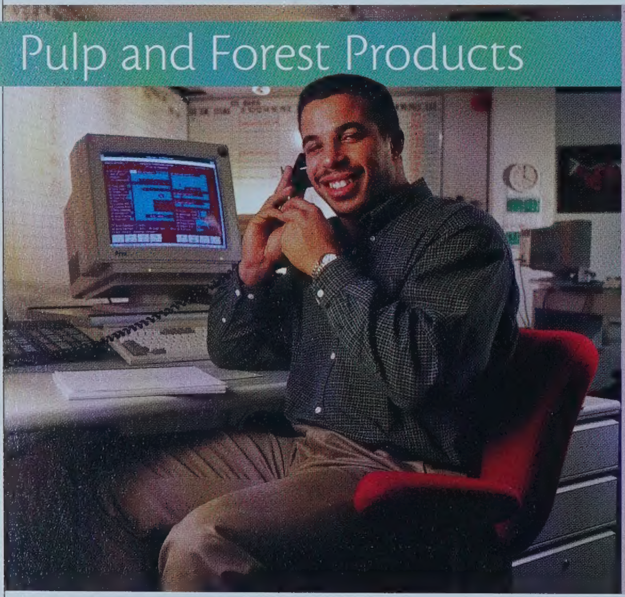
Paper mills (3)
and annual production capacity:

WINDSOR, QUÉBEC
540,000 tons
CORNWALL, ONTARIO
220,000 tons
ST. CATHARINES, ONTARIO
46,000 tons

Domtar Merchants (8)
Buntin Reid:
MISSISSAUGA, ONTARIO;
OTTAWA, ONTARIO;
LONDON, ONTARIO
JBR La Maison du Papier:
LACHINE, QUÉBEC;
QUÉBEC CITY, QUÉBEC
The Paper House:
DARTMOUTH, NOVA SCOTIA;
MOUNT PEARL, NEWFOUNDLAND;
SAINT JOHN, NEW BRUNSWICK

Employees: 2,590

Pulp and Forest Products



Pulp mill (1)

LEBEL-SUR-QUÉVILLON, QUÉBEC

Annual production capacity:
280,000 tonnes

Private and public lands:
66,600 km^2 or
4.6 million cubic metres

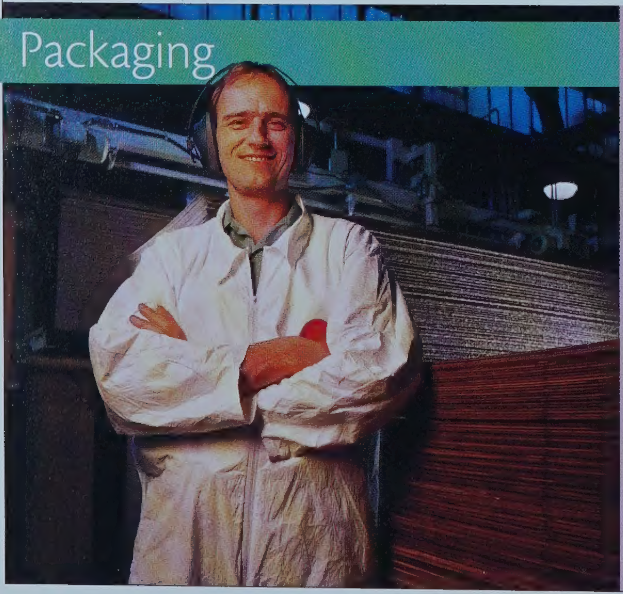
Sawmills (10)
QUÉBEC (9):
GRAND-REMOUS; LEBEL-SUR-QUÉVILLON;
MALARTIC; MATAGAMI;
SAINTE-AURÉLIE; SAINTE-FRANÇOISE;
SAINTE-MARIE; SULLIVAN; VAL D'OR

ONTARIO (1):
WHITE RIVER

Annual production capacity:
750 million board feet

Employees: 1,974

Packaging



NORAMPAC INC.,
50%-owned by Domtar in joint venture with Cascades Inc., which began operations on January 1, 1998.

Containerboard mills (3)
and annual production capacity:
RED ROCK, ONTARIO
345,000 tonnes
KINGSEY FALLS, QUÉBEC
65,000 tonnes
MISSISSAUGA, ONTARIO
140,000 tonnes

Corrugated medium mills (3)
and annual production capacity:
TRENTON, ONTARIO
167,000 tonnes
CABANO, QUÉBEC
165,000 tonnes
NIAGARA FALLS, NEW YORK
150,000 tonnes

Linerboard and corrugated medium mill (1):
AVOT-VALLÉE, FRANCE
100,000 tonnes

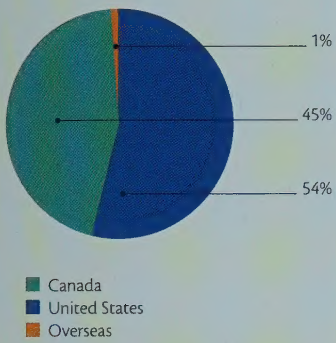
Total Capacity:
1,132,000 tonnes

Corrugated container plants (23):
NEW BRUNSWICK (1); QUÉBEC (7);
ONTARIO (11); MANITOBA (1);
ALBERTA (1); BRITISH COLUMBIA (1);
NEWFOUNDLAND (1)

Total pro forma
1996 Shipments:
8,760 million sq. ft.

Employees: 4,003

Fine Papers
Sales

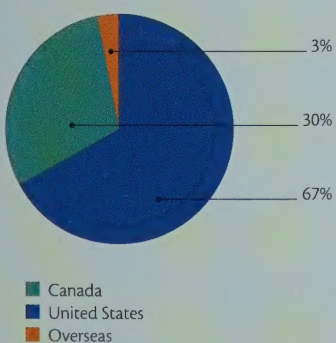


Major product lines
Premium text, writing and cover, premium offset text and cover, bristol, tags, cover and boards, Cornwall coated cover, packaging grades, file folders, photocopy paper, bond paper for forms and computer printouts, envelope paper, offset printing paper, opaque offset, colour offset and copy.

DOMTAR MERCHANTS:
Domtar operates a network of fine paper warehouses.

Highlights
- The Windsor Business Centre significantly enhanced profitability and celebrated its 10th anniversary in 1997.
- Hourly throughput on the Windsor mill's new cut-size sheeter jumped 27% during the year.
- Windsor Offset ranked #1 in North America in terms of print quality for both web and sheet-fed printing processes.
- New range of retail products introduced aimed at the fast-growing and lucrative SOHO (small office/home office) and home computer markets.
- St. Catharines, Ontario mill became the division's main source of specialty fine papers.
- Cornwall, Ontario paper mill maintained the same level of production although down from 5 to 3 machines.

Pulp and Forest Products
Sales

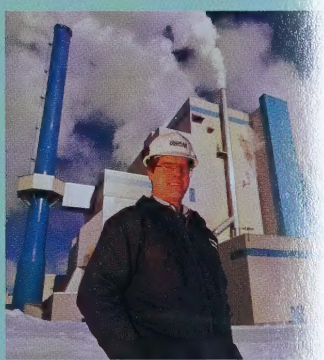


Major product lines
MARKET PULP:

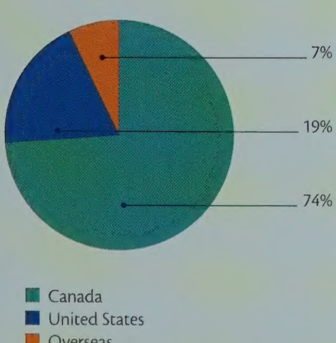
(Northern Softwood Kraft Pulp):
- Bleached
- Unbleached

LUMBER:
- Kiln-dried dimension and studs primarily for residential construction;
- Rough-sawn lumber for industrial use and re-manufacturing;
- Value-added lumber products.

Highlights
- A $245-million modernization program was completed at the Lebel-su Québec pulp mill. This included the start-up of a new recover boiler at the Norkraft mill aimed at improving operating performance in 1998 and a turbo-generator which will substantially reduce energy costs.
- Start-up of the $6-million Nabakatuk Forestry Products sawmill, 45%-owned by Domtar with the remainder owned by the Cree First Nation of Waswanipi, in Northern Québec.
- Investment in a venture to produce value-added, engineered wood at Daveluyville, Québec.
- Completed start-up of new equipment at White River, Ontario and Lebel-sur-Quévillon, Québec sawmills.



Packaging
Sales



Major product lines
CONTAINERBOARD:
- Linerboard (recycled and virgin)
- Corrugating medium

CORRUGATED CONTAINERS:
Point-of-purchase promotional material

RECYCLING:
Norampac is also a leading recycler of waste papers.

Highlights
- Stake in largest producer of containerboard in Canada and largest box plant network in Canada.
- Domtar received $300 million in proceeds from transaction.
- The $55-million Red Rock, Ontario modernization program was completed in 1997.
- First anniversary of the unique closed-loop process effluent system at Trenton, Ontario.
- Concord, Ontario corrugated container plant became the first North American box plant to meet ISO 14000 certification.
- Seven awards were captured at the 1997 National Packaging Competition.
- Successful start-up of a new shoe press at the Mississauga, Ontario box plant.

Domtar is a leading designer, manufacturer and distributor of fine papers, packaging, pulp and forest products for North American and international markets.

Its mission is to create value for its customers, shareholders and other business partners. It achieves this by tapping the know-how, creativity and professionalism of its employees to serve the needs of its customers and to develop new markets. A socially and environmentally-responsible organization, it provides innovative and quality products and services in a cost-effective and timely manner.

TABLE OF CONTENTS

Telling the story of 1997 provides an opportunity to shine a spotlight on some of the thousands of Domtar's employees. The cover features (from left to right): Carole MacPhee, Pulp and Forest Products; Billy Abner, Pulp and Forest Products; Claude Bazin, Fine Papers; Diane Calfat, Domtar Merchants; Christian Fleury, Norampac Inc.

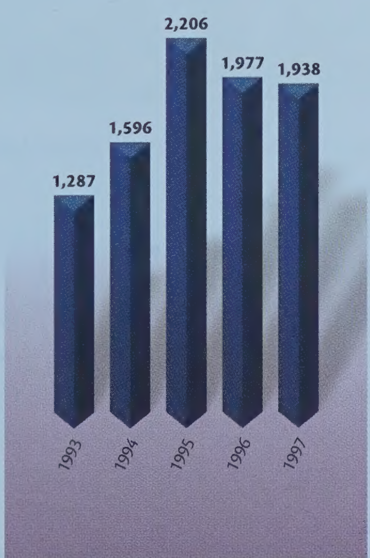
FINANCIAL HIGHLIGHTS

(in millions of Canadian dollars, except per share amounts and statistical data)

	1997	1996	1995
Sales	$ 1,938	$ 1,977	$ 2,206
Operating profit	56	74	509
Net earnings	25	97	304
Total assets	2,962	2,709	3,191
Per common share			
Earnings (loss) from continuing operations			
Basic	$ 0.15	$ (0.69)	$ 1.80
Fully diluted	*	*	1.41
Net earnings			
Basic	$ 0.15	$ 0.68	$ 2.32
Fully diluted	*	0.63	1.80
Year-end book value	$ 8.03	$ 8.04	$ 7.56
Share price at year end on Montréal Exchange	$ 9.95	$ 11.60	$ 10.625
Common shares outstanding (millions)	149.5	150.4	127.8
Return on common shareholders' equity	2%	9%	37%
Debt-to-total-capitalization ratio *(1)*	33:67	32:68	40:60

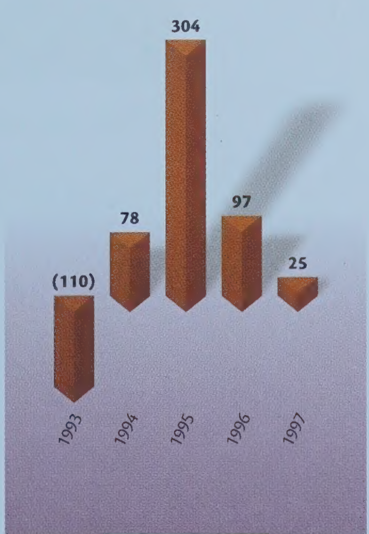
(1) Ratio of debt, net of cash, of short-term investments and of short-term deposits held in trust, to total capitalization.

* *No dilution or antidilutive*



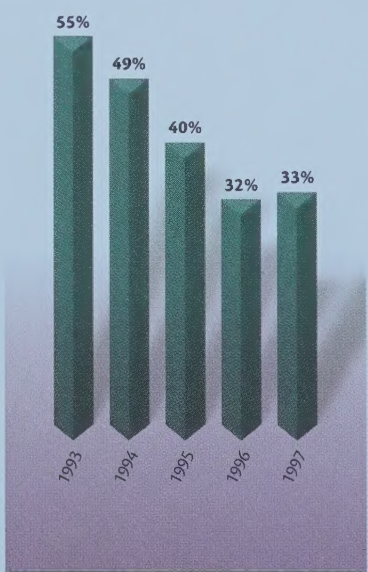
SALES

(in million of $)



NET EARNINGS (LOSS)

(in million of $)

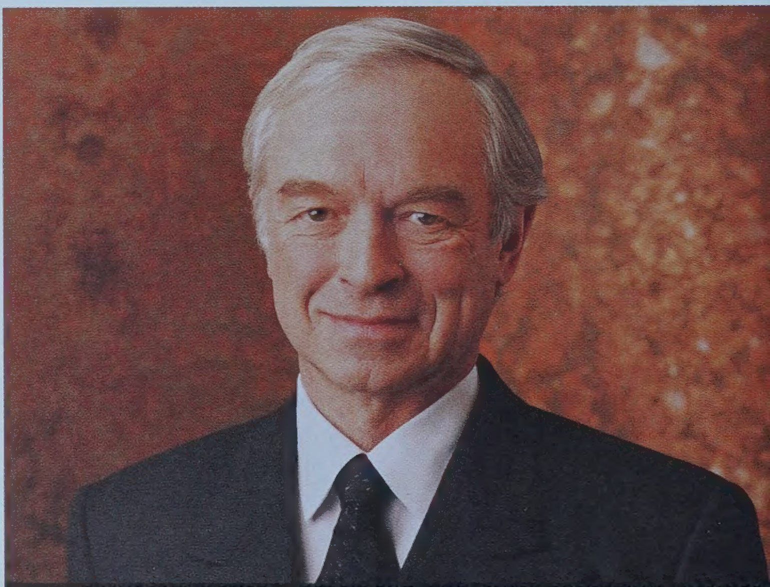


DEBT-TO-TOTAL-CAPITALIZATION PERCENTAGE

BUILDING SUCCESS for the Corporation

CUSTOMERS SHAREHOLDERS EMPLOYEES

In 1997, a difficult year for the North American pulp and paper industry, Domtar was able to remain profitable due primarily to an aggressive, company-wide, productivity and cost improvement program and a reduction in financing expenses.



RAYMOND ROYER – PRESIDENT AND CHIEF EXECUTIVE OFFICER

This performance was achieved despite notably weak prices, especially in the first half of the year. The Corporation also successfully addressed the strategic issue of its packaging division and, by creating the joint venture Norampac Inc., positioned itself to capitalize on growth opportunities.

FINANCIAL RESULTS

The Corporation posted net earnings of $25 million, or $0.15 per common share, compared with net earnings of $97 million, or $0.68 per common share, in 1996. Significantly lower prices in 1997 had an important negative impact on operating profit for the year. Nonetheless, we achieved net earnings before non-recurring items of $8 million in 1997, or $0.04 per common share, which compared to $23 million, or $0.12 per common share, in 1996.

PRODUCTIVITY AND COST IMPROVEMENT PROGRAM

The primary reason for this performance was a company-wide, productivity and cost improvement program launched by the Corporation in late 1996. During 1997, Domtar exceeded the program's $50-million target by 40%, achieving total savings of $70 million, net of inflation. The program's success largely compensated for the negative impact of the decline in selling prices estimated at more than $100 million.

MERGER OF PACKAGING ASSETS

The merger of the Corporation's packaging assets with those of Cascades Inc. is worthy of mention. This alliance created the largest producer of containerboard and corrugated containers in Canada and one of the 10 largest in North America. The ideal fit of the two packaging operations will enable the new entity, Norampac Inc., to benefit from annual synergies in excess of $50 million, while significantly improving its competitive position.

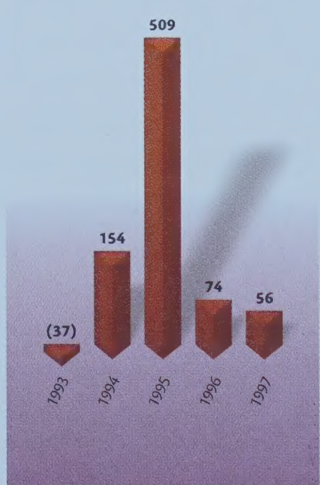
As a result of the transaction, Domtar received $300 million cash and a 50%-ownership in the joint venture. About $100 million was used to repay bank loans while $200 million was retained to provide increased financial flexibility. The Corporation's percentage of net debt-to-total-capitalization, including our 50% share of the Norampac non-recourse debt, stood at 33% as of December 31, 1997, reflecting an excellent balance sheet compared to most industry peers. Lastly, this transaction has given Domtar a total, pre-tax gain of $196 million, of which $25 million was accounted for in the 1997 results.

The Corporation's overall financial results for 1997 were significantly impacted by three operational issues, all of which have been resolved, namely the start-ups at both the Red Rock, Ontario, and Lebel-sur-Quévillon, Québec, mills, and a work disruption at the Grand-Remous, Québec, sawmill.

STRATEGIC ORIENTATION FOR 1998 ONWARDS

Over the past year, Domtar has moved ahead with the implementation of a comprehensive corporate strategy. New competitive pressures that forest product companies are facing globally, coupled with poor historical returns, will force a continuation of an already intense industry rationalization process. Our aim is to strengthen Domtar's position within the industry and enable it to take full advantage of any growth opportunities. We believe that the winners in our industry will be those who can best integrate efforts to enhance product quality and customer service while optimizing the use of their human resources and capital assets at each step of the process.

Domtar's objective is to join the front ranks of North American pulp and paper companies as measured by superior financial returns, and to do so as quickly as possible.



OPERATING PROFIT (LOSS)
(IN MILLIONS OF $)

The Corporation's strategic orientation is based on three stakeholders important to our success: customers, shareholders and employees. It entails:

- anticipating and meeting the ever-changing needs of our customers;
- providing our shareholders with attractive returns throughout the business cycle; and
- fostering a dynamic and innovative environment where the creativity and personal commitment of Domtar's people will prevail.

Our strategy is also based on the need to develop more rigorous management processes that will allow us to rise above competitors and on the need to remain profitable regardless of the prices we receive for our products.

INCREASE CUSTOMER FOCUS

BECOME A BEST-COST OPERATOR

FOUR STRATEGIC THRUSTS

To accelerate our progress towards these goals, Domtar is focused on four strategic thrusts:

- **First, Domtar's goal is to be a best-cost operator in its main businesses.** The Corporation began by reducing costs, improving product quality and optimizing fibre usage throughout its operations. In addition, as we are aware that we will be able to achieve better results only if we capitalize on the intelligence and creativity of the thousands of Domtar employees, we have begun to effect a corporate culture change in the organization. For example, the traditional scope of the human resources function has been expanded to encompass work organization – an essential first step in removing barriers to improved productivity and speeding up the internal dissemination of best practices.

In order to mobilize employees and achieve the objectives of our business plan, we believe it is crucial to provide a safe and rewarding working environment with stable employment opportunities. For this purpose, Domtar's human resource management philosophy emphasizes building win-win relationships with employees.

SEEK NEW VALUE-CREATION OPPORTUNITIES

■ **Secondly, we want to increase our customer focus.** We aim to create a closer relationship with our customers in order to better understand and meet their evolving needs. Accordingly, a review of the main components of our products and services has begun and benchmarking studies to assess our strengths and weaknesses vis-à-vis our competitors have been conducted. Concrete action plans have already been developed to significantly increase customer satisfaction.

OPTIMIZE ASSET PORTFOLIO

■ **Thirdly, we must optimize our asset portfolio.** The core of our strategy is to optimize assets in our principal businesses in order to build a solid and permanent profit base. This already has been accomplished in the packaging sector.

The goal is to bring all of Domtar's operations to the highest possible level on the industry performance curve, thereby positioning them to deliver consistent, attractive financial returns. Some of the facilities – the Windsor fine paper mill, for instance – are in leading positions, while others lag behind their respective industry leaders. All of Domtar's operations must strive to excel and make the necessary adjustments to achieve competitive results.

■ **Finally, we will make it a priority to seek out new value-creation opportunities.** By this we mean developing initiatives that will establish or strengthen leading positions in terms of market share and competitiveness. We will also examine the possibility of increasing our operational presence in the United States, where most of our customers are located. This will provide an additional hedge against fluctuations in the exchange rate of the U.S. dollar. In addition, we will continue to explore opportunities that present themselves as a result of the consolidation of the North American pulp and paper industry.

OTHER KEY INITIATIVES AND ACHIEVEMENTS IN 1997

Best-cost Producer

■ We are beginning to see real benefits from prior investments and restructuring efforts throughout Domtar's operations. This is most obvious at the fine paper mill in Cornwall, Ontario, and at both the pulp mill and sawmill in Lebel-sur-Quévillon, Québec. These improvements augur well for the future. For instance, we are moving ahead rapidly at the Lebel-sur-Quévillon pulp mill, now that the major modernization project and start-up have been completed. At this mill, we have created an environment to facilitate the full cooperation of employees in order to further improve the facility's performance and customer support. For instance, employees have agreed to reduce the number of job classifications from 65 to six, allowing for considerable productivity improvements.

■ We reviewed capital expenditure policies to ensure that all projects are subjected to stringent evaluation criteria. We delivered on our promise of early 1997 to manage capital expenditures strategically and prudently, limiting operational investments to projects that would provide EVA (Economic Value Added).

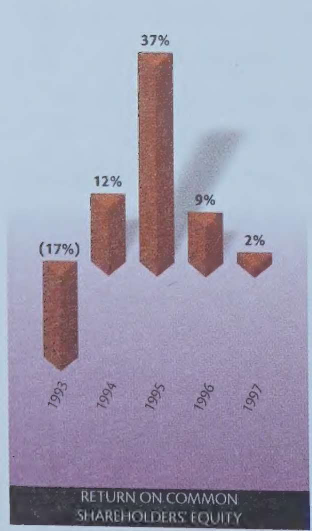
■ We are also implementing new training programs, designed to develop employee creativity and foster a culture in which the identification and resolution of problems facilitate swift and continuous improvement throughout the Corporation.

In Partnership With Clients

■ We undertook an assesment of the competitive advantages of each wood species harvested on the lands we manage and, in order to improve product quality, we intend to implement measures that will optimize their respective utilization in the pulp and lumber manufacturing process.

■ In the Fine Papers division, we took advantage of the premium position of the Windsor product line to increase U.S. penetration of our semi-commodity papers produced at the Cornwall and St. Catharines mills.

■ We continued important investments in computer and inventory management systems to improve customer service and response times in the Fine Papers division. These investments paid off in 1997 as the division joined the ranks of the top five North American producers recognized in industry ratings as the most customer-oriented.



Optimization of Asset Portfolio

■ We further improved our operating profile by forging the $1-billion merger of Domtar's packaging operations with those of Cascades Inc. to create Norampac. We intend to make the joint venture a top-quartile producer that will offer the potential for a larger stream of earnings in the future. This transaction is an example of an innovative strategy aimed at creating value for shareholders.

■ The sale of the Beauharnois, Québec specialty and security papers mill was completed during the course of the year.

Value Creation through Growth

■ We have continued efforts to strengthen our financial position and maintain our debt at a moderate level while holding important cash reserves. This will allow us to pursue acquisitions, mergers or other growth options, which meet our value creation objectives.

■ Our research and development efforts have strongly contributed to improved product and manufacturing processes and to creating added value for our customers and shareholders.

■ The EVA-based incentive compensation program was extended to include all non-negotiated employees in order to better align their interests with those of our shareholders.

■ In cooperation with the Cree First Nation of Waswanipi, Québec, we inaugurated a new $6-million sawmill in Northern Québec, representing the first such partnership in the Canadian forest products industry. The Cree community has a 55%-equity investment in the venture and Domtar the remaining 45%.

■ Over the course of the last year, discussions were held with various pulp and paper companies to explore ways of creating value for our shareholders. We will continue such efforts in 1998.

JACQUES GIRARD AND RAYMOND ROYER

YEAR 2000 ACTION PLAN

In early 1997, Domtar set up a task force to identify and address all Year 2000-related computer programming issues in order to ensure both full compliance with software requirements and a smooth transition. A detailed action plan and an appropriate budget have since been approved and will be implemented over the next two years. Management does not anticipate difficulties in meeting the deadlines.

CHANGES TO THE BOARD OF DIRECTORS

The Board welcomed Ms. Louiselle Paquin, Ms. Louise Roy and Mr. Brian M. Levitt during the course of 1997. We would like to thank Messrs. J.V. Raymond Cyr and Marc G. Fortier who departed after four and six years, respectively, as directors. On behalf of all Board members, we would like to express our appreciation for their important contributions to Domtar.

LOOKING AHEAD

Due to the continued strength of the North American economy, demand for our key products is expected to remain fairly good. At this point in time, it is difficult to assess the impact on our business of the turmoil in Asian economies. We believe industry fundamentals remain sound and that the Asian situation will further slow the expansion of international capacity in the foreseeable future. Market pulp prices are perceived to be somewhat more at risk, but the Corporation's exposure in this sector remains relatively small, with annual production of only 200,000 metric tonnes, or less than 10% of total sales.

Overall, we have a solid base on which to build. Domtar's Fine Papers division is by far the largest producer in Canada, the eighth largest in North America and ranks 11th worldwide. Similarly, the Norampac joint venture is the leading containerboard manufacturer in Canada and tenth in North America. Our Forest Products group is the third largest in Eastern Canada.

This year, our top internal priority is to deliver on the next phase of our productivity and cost improvement program with a 1998 target – net of inflation – of $30 million. This will help us achieve or maintain leadership positions in our core activities and, by the end of 1999, make Domtar one of the best North American performers in terms of financial returns in its industry.

We are confident that Domtar is also well positioned to meet its other major challenge for the future: to seize on strategic external opportunities for profitable growth.

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The members of the Board of Directors and the management team would like to thank employees for their sustained efforts during the year and their contribution in achieving the results of the 1997 productivity and cost improvement program.

Jacques Girard
Chairman of the Board

Raymond Royer
President and
Chief Executive Officer

BUILDING
SUCCESS in Fine Papers

The Fine Papers Division had a remarkable year in 1997. Profitability improved, production increased and customer satisfaction continued to climb. The division also successfully completed the strategic restructuring of its Cornwall and St. Catharines, Ontario mills.

Windsor mill *on target* with enhanced returns

The Windsor, Québec fine paper mill significantly enhanced its profitability in 1997. Operating income for the year increased 12% despite a continued difficult pricing environment. In 1998, the goal of the Windsor Business Centre, which celebrated its 10th anniversary last year, is to further improve its profitability. Thanks to an all-out effort by employees, the management team is confident that new heights in performance will be reached.

Gains have been made in virtually every area of the operation, including wood yield, fibre mix, pulp mill output and paper machine productivity. Throughput in the finishing department has also been improved and its total yield substantially increased.

Among key performance indicators at Windsor in 1997:

- Total annual output of paper increased by 3,000 tons over 1996;
- Total annual output from the pulp mill rose by more than 7,000 tons; and
- Hourly throughput on the mill's newest cut-size sheeter jumped 27%.

A renewed focus on product and customer mix also led us to augment our margins as product offerings better matched evolving customer needs.

SERGE ALEXANDRE – WINDSOR

Internet: high-tech *marketing tool*

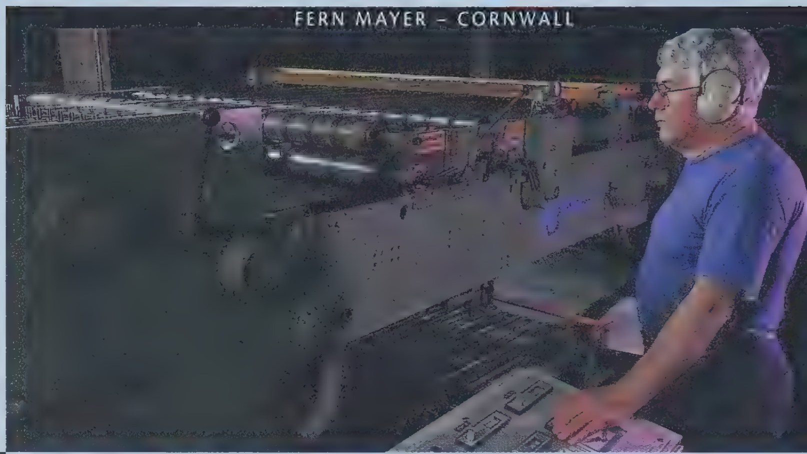
Domtar Fine Papers has gone high-tech in its pursuit of new markets and increased customer convenience. Orders are now being accepted on-line for the retail group's desk-top publishing papers. Customers and shareholders are invited to view the latest on-line offerings at the Domtar Papers web site – www.domtar.com/papers

Windsor Offset *ranks #1* in North America

Benchmarking enables us to objectively measure our success in providing superior products and service.

Independent tests conducted recently in the United States ranked Domtar's Windsor Offset #1 in terms of print quality for both web and sheet-fed printing processes for the third-consecutive year. The fact that Domtar came out on top in this benchmarking exercise, which compared Windsor Offset with other papers from five leading North American producers of commodity offset, is proof positive that our constant efforts to provide the very best products are paying off.

Cornwall and St. Catharines *deliver on strategy*


FERN MAYER – CORNWALL

At the Cornwall, Ontario mill, building success is focused on a two-pronged strategy aimed at realizing substantial cost and productivity improvements while increasing sales of the mill's main product lines.

Productivity at the mill improved significantly during the year: with gains of 12% on the coated paper machine and 15% in the finishing department – excellent results given the impact of a major restructuring of the manufacturing and marketing activities initiated during the previous year.

Two no-longer competitive paper machines were shut down at Cornwall during 1996, yet virtually all of the lost volume has been recovered through improved operation of the three remaining machines. Average daily production increased 7% in 1997 compared to 1996.

On the marketing side, the business unit managed not only to boost volumes of its key products – Cornwall Coated Cover and Plainfield Plus Opaque Offset – but also to achieve a significantly better product mix by increasing sales of stock items where margins are best.

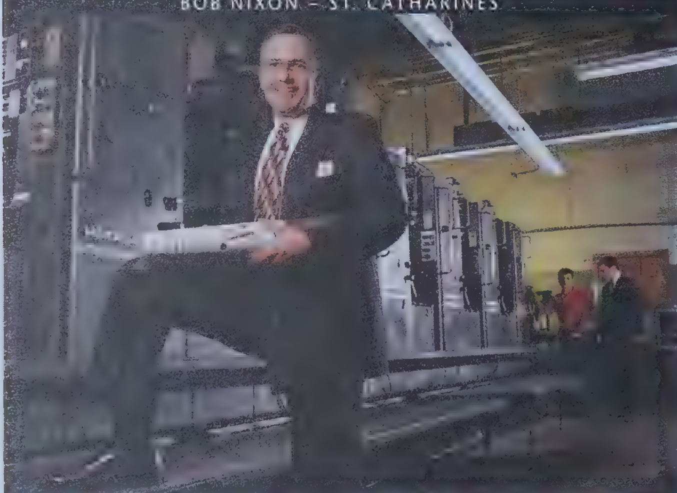
There was also a marked improvement in the performance of the St. Catharines, Ontario mill, which has evolved into the division's main source of specialty fine papers. An all-out effort by employees enabled the business unit to make significant gains in terms of cost controls and efficiency, while repositioning its product and customer mix to focus on more profitable grades. Development of a new line of recycled papers, which entailed close cooperation between mill staff and Domtar R&D specialists, was near completion at the end of the year.

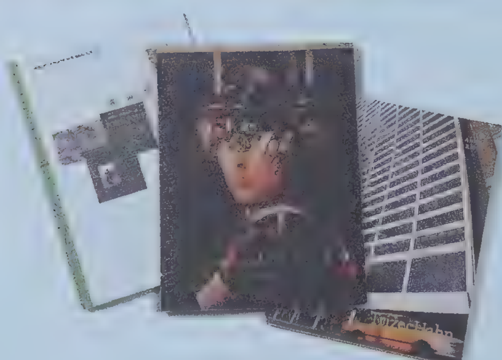
In Good Company

QUALITY DOMTAR PAPERS FAVOURED FOR ANNUAL REPORTS

Success is often reflected in the company we keep. So we are pleased to note that prestigious organizations such as the Toronto-Dominion Bank, printer Arthur Jones Inc. and Maxxum Insurance Group are among the many corporations that selected Domtar fine papers for their 1997 annual reports. Domtar's growing North American reputation for delivering superior quality and value translated into significant volume increases for our leading printing and writing grades in 1997.

BOB NIXON – ST. CATHARINES





New retail lines *a hit* with major chains

During 1997, Domtar introduced a new range of retail products aimed specifically at the fast-growing SOHO (small office/home office) and home-computer markets.

The Business and Expression lines include pre-printed papers suitable for a multitude of business and consumer desktop-publishing applications. They have proven to be a hit with shoppers at major national retailers such as Business Depot, *Bureau en Gros*, Office Depot, Pilon, Staples, Wal-Mart and Zellers.

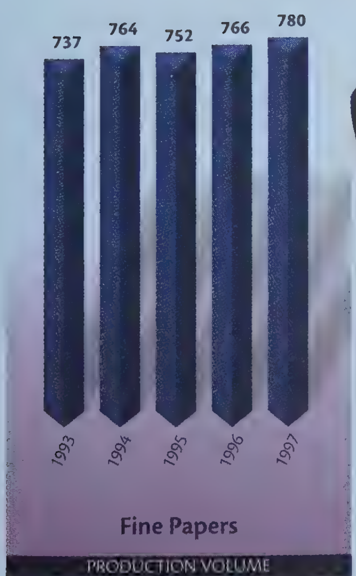
MÉLANIE DINEL – MONTRÉAL

Division targets *further gains* for '98

Customer satisfaction, productivity improvement and cost reduction remain key priorities of Domtar's Fine Papers strategy for 1998.

Specific goals and initiatives for the year ahead include:

- Achieving additional productivity improvements at Windsor;
- Renegotiating wood supply contracts to reflect current market realities and reduce raw materials costs;
- Enhancing customer service by extending the division's new integrated, computer information system to Cornwall;
- Further increasing sales of the Cornwall mill's main product lines, while continuing to deliver on cost and productivity gains; and
- Introducing an exciting new line of text and cover papers that will contribute to increased production volumes at St. Catharines.



(in thousands of tons)

Domtar Merchants delivers *strong performance*

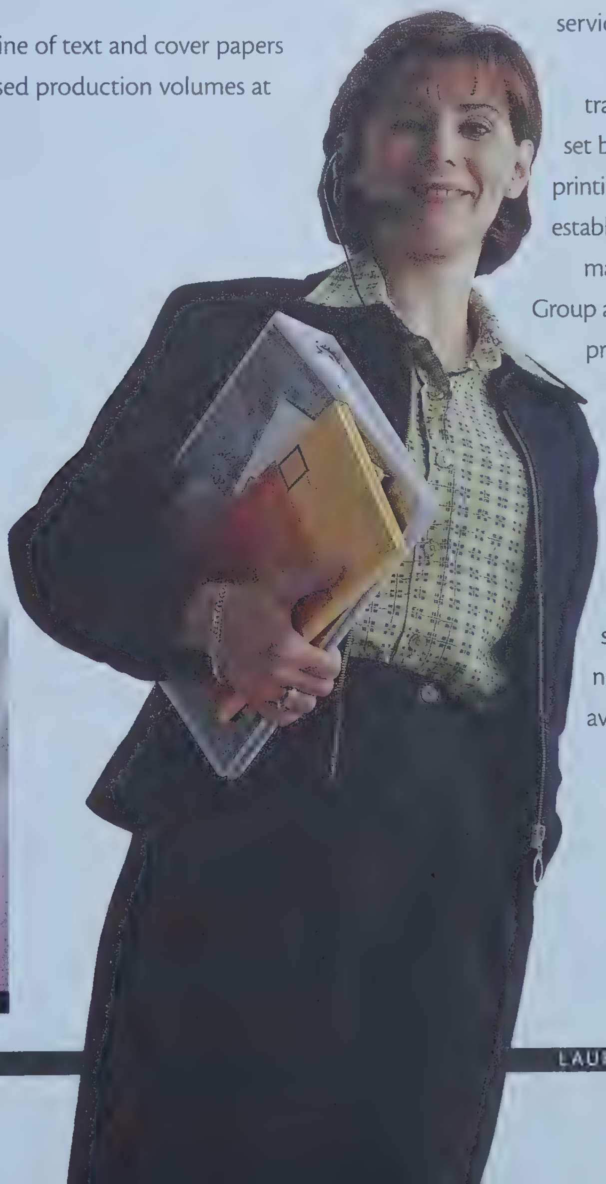
Domtar Merchants operates an extensive distribution network serving graphic-arts and office-papers customers throughout Eastern Canada: Buntin Reid, *JBR La Maison du Papier* and The Paper House provide a direct pipeline from the Corporation's fine paper mills to the marketplace.

Although the merchant sector was hit by an industry-wide decline in both volumes and margins during 1997, a relentless emphasis on cost reduction enabled Domtar Merchants to counter the trend and remain profitable in the face of widespread price discounting.

The unit consolidated its Toronto operations by closing a distribution facility acquired through the 1995 acquisition of *J.B. Rolland et Fils*, while reinforcing its commitment to provide all its customers with a range of products and a level of service that represent superior value.

Reduced volumes in the tender/contract segment of the market were largely offset by improved penetration of the commercial printing market, where Domtar Merchants established and/or expanded partnerships with major industry players such as the MDC Group and St. Joseph's Printing. A number of new product offerings aimed at the graphic arts sector were well received. And an emphasis on telemarketing paid off in increased sales, particularly in the Ottawa, London and Toronto-area markets.

During 1998, Domtar Merchants will continue its focus on costs and customer service, while exploring new products and new markets that represent potential avenues to success.



LAURA FAUSTINI GATTOLA - MONTRÉAL

SUCCESS in Pulp and Forest Products

The Division's results in 1997 were adversely affected by increases in stumpage fees, a prolonged work interruption at one of its sawmills, a reduction in production volumes and the start-up of new equipment. However, with the completion of the major modernization at the Lebel-sur-Quévillon, Québec mill and the launch of an innovative work reorganization program, the division stands to benefit from productivity gains and will be better positioned to face today's competitive markets.

Work reorganization will help Norkraft realize *full potential* of modernization

In today's intensely competitive business environment, building success and creating value often entail rethinking the traditional way of doing things. A breakthrough agreement on work reorganization, reached after extensive consultation with unions representing Norkraft employees, will help the division realize the full potential of the recently completed $245-million modernization program at its Lebel-sur-Quévillon kraft pulp mill.

A key element of the pact calls for the number of job classifications covered by the collective agreement to be slashed from 65 to six. Once the reorganization has been fully implemented, this measure is expected to yield savings of up to 5% of the mill's cost per tonne of output – added cause for celebration at a facility that marked its 30th anniversary during 1997.

LÉO POIRIER – LEBEL-SUR-QUÉVILLON


FRANÇOIS HÉON – LEBEL-SUR-QUÉVILLON

Premium quality pulp *responding to* customer needs


ROBERT FORGET – INNOVATION CENTRE

The Norkraft business unit is constantly on the lookout for ways to improve its product mix and meet changing customer needs.

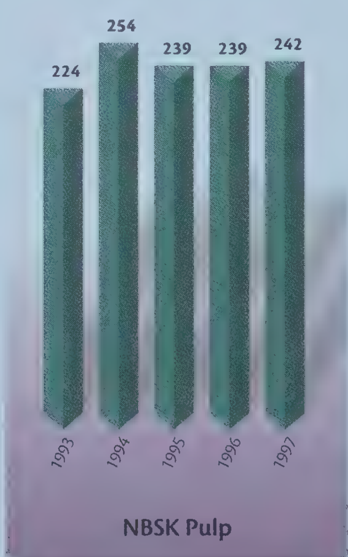
In 1997, the Division met with customers to identify their specific requirements for softwood pulp. Based on those consultations, we will produce pulp formulated to better meet customers' needs while capitalizing on the unique properties of the fibre harvested in the Abitibi region of Northern Québec.

The initiative to develop a commercially viable "tailored-to-measure" pulp entails close cooperation between divisional staff and specialists from Domtar's Innovation Centre at Senneville, near Montréal. This is typical of the Corporation's multi-disciplinary approach to R&D, which aims to mobilize know-how from every facet of our operations in order to develop winning products and processes and make optimal use of available fibre resources.

Output and productivity *increases* top agenda at pulp mill

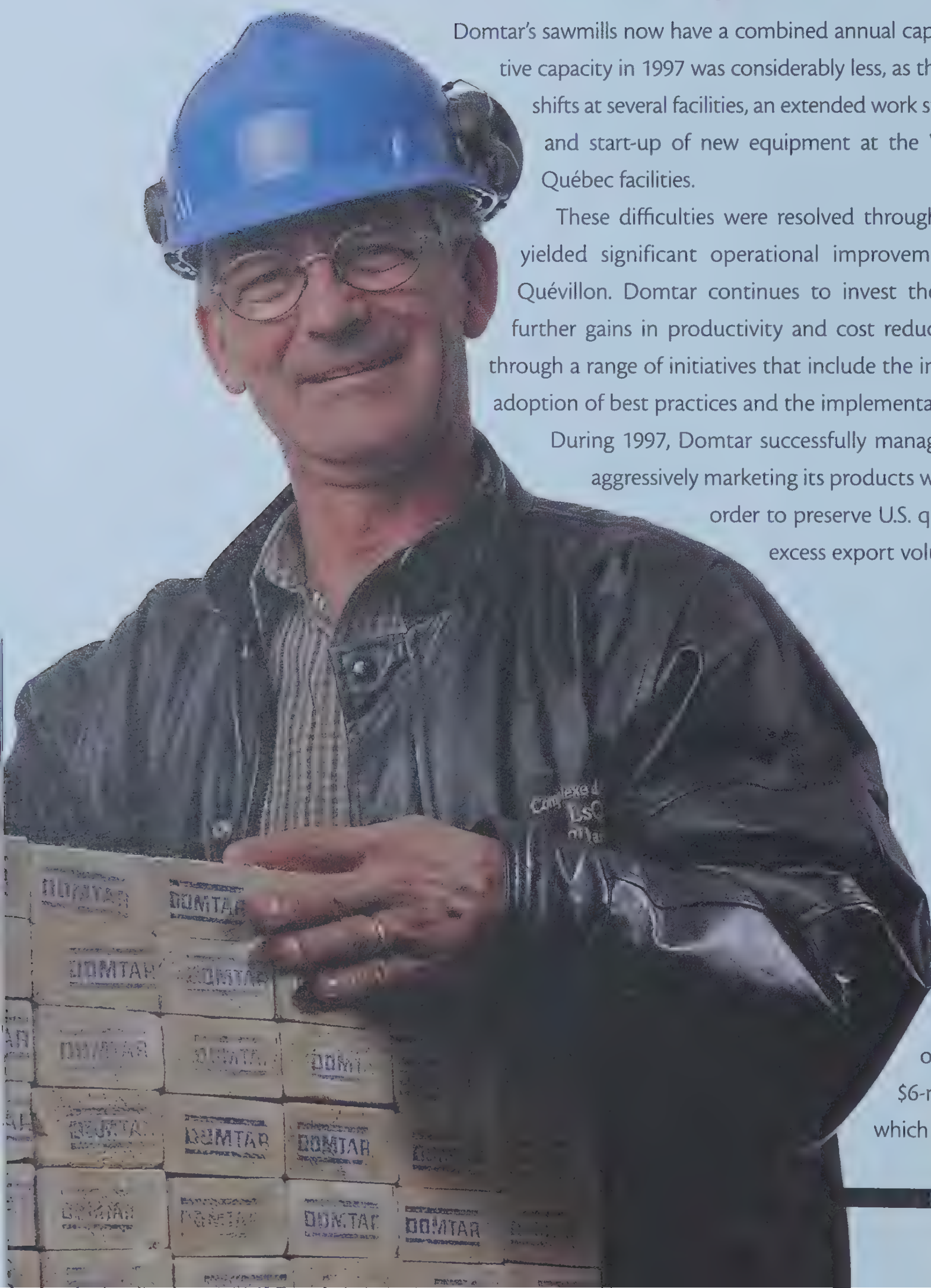
With the start-up of a new recovery boiler in June 1997 and other modifications to reduce unplanned mill down-time, the Norkraft unit is aiming for a substantially improved operating performance in 1998. Goals include increasing average mill output and improving overall profitability by 5% on a year-over-year basis. The start-up of a new turbogenerator in December 1997 will substantially reduce energy costs.

All processes and equipment at the mill are subject to close scrutiny as part of a more rigorous *modus operandi* designed to further reduce costs, eliminate disruptions to production and – ultimately – create increased value for the Corporation.



PRODUCTION VOLUME
(in thousands of tonnes)

Sawmills focus on *productivity improvement*



Domtar's sawmills now have a combined annual capacity of 750 million board feet. However, effective capacity in 1997 was considerably less, as the result of a reduction from three to two work shifts at several facilities, an extended work stoppage at the Grand-Remous, Québec sawmill and start-up of new equipment at the White River, Ontario and Lebel-sur-Quévillon, Québec facilities.

These difficulties were resolved through the introduction of action plans that have yielded significant operational improvements, particularly in the case of Lebel-sur-Quévillon. Domtar continues to invest the relatively modest sums required to realize further gains in productivity and cost reduction at its sawmills. Such gains are achieved through a range of initiatives that include the installation of new process control systems, the adoption of best practices and the implementation of preventive maintenance programs.

During 1997, Domtar successfully managed its quotas for lumber exports to the U.S., aggressively marketing its products within Canada during the first half of the year in order to preserve U.S. quotas and minimize the penalties imposed on excess export volumes.

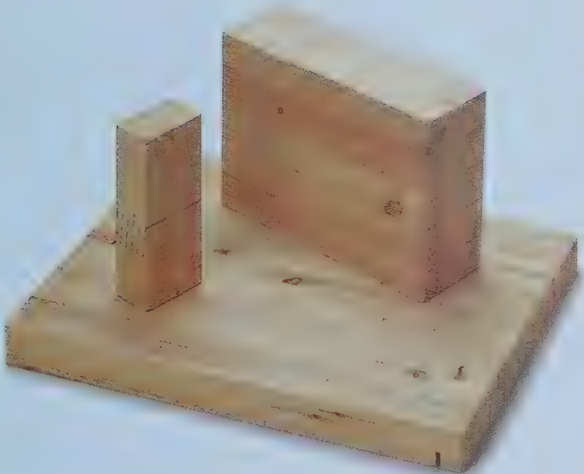
Joint venture with Waswanipi Cree an industry first

NABAKATUK

Aboriginal people have a direct stake in the success of Domtar's newest sawmill, a pioneering joint venture with the Waswanipi Cree First Nation of Northern Québec. Initial output has exceeded projections at the new, $6-million Nabakatuk Forestry Products sawmill, which began operations in June 1997.

RÉJEAN PILON – LEBEL-SUR-QUÉVILLON

Value-added ventures aim to enhance *profitability* and generate growth



MANON GAGNÉ – LEBEL-SUR-QUÉVILLON

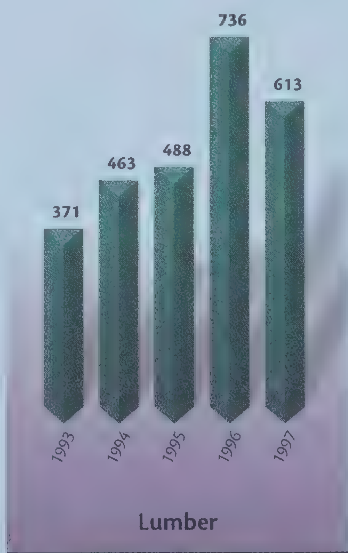
As part of its strategy to maximize margins per unit of production, Domtar formed a new team to explore and develop opportunities in value-added products such as engineered woods and stress-rated products, which involve second- and third-stage transition from raw lumber.

The first such venture up and running is a new lumber remanufacturing facility at Sullivan, Québec, which produces bed frames and fence components that are not subject to quotas when exported to the United States. Domtar has also made an investment in an engineered wood facility at Daveluyville, Québec with an annual production capacity equivalent to 30 million board feet. Products being considered for this plant include pine flooring, multi-ply panels used in cabinetmaking and wooden interior cores for fire doors.

THE AGENDA FOR 1998

Domtar's 1998 priorities for lumber and forest products include:

- Continued emphasis on cost and productivity issues;
- Further improvements to both product and customer mix;
- Preparation of an updated Corporate Forestry Policy that will reflect the latest practices and regulations, in keeping with Domtar's commitment to responsible resource management;
- Completion of a biomass co-generation facility at the White River, Ontario sawmill. To be built and financed by a third party, it will yield both energy savings and environmental benefits.

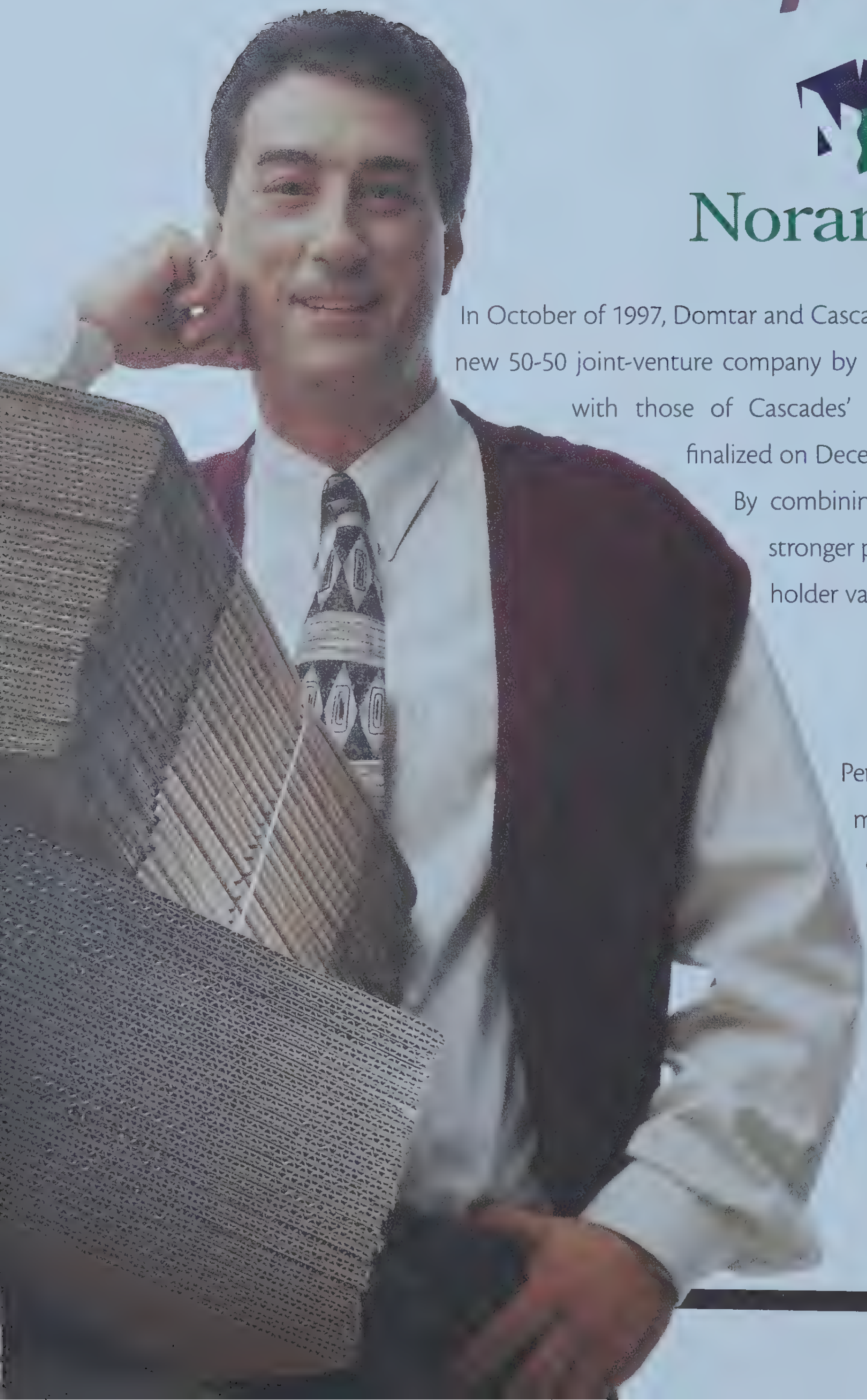


PRODUCTION VOLUME
(in millions of board feet)

Norampac Inc., 50% owned by Domtar, is Canada's largest producer of containerboard and corrugated containers and one of the 10 biggest in North America.

Ideal fit *in packaging* joint venture

Norampac Inc.



In October of 1997, Domtar and Cascades Inc. announced that they had agreed to form a new 50-50 joint-venture company by merging the assets of Domtar's Packaging division with those of Cascades' containerboard operations. The transaction was finalized on December 30, 1997.

By combining forces, the two partners have created a much stronger packaging business that will result in enhanced shareholder value.

New shoe press yields gains at Mississauga mill

Personnel at the Mississauga, Ontario containerboard mill teamed up with specialists from the Innovation Centre during 1997 to undertake the successful installation and start-up of a new shoe press – technology that substantially improved performance at the mill. The installation was completed on time and on budget, and the new press is already yielding measurable cost and productivity gains.

RICHARD GUAY – MONTREAL

Trenton turns out *high-performance* corrugating medium

MARK ABERNETHY – TRENTON

The Trenton, Ontario mill, working in conjunction with the Domtar Innovation Centre, has succeeded in producing a high-performance corrugating medium that will enable the division to seek out potentially attractive new markets here and abroad.

European and South American customers were among the buyers of the initial production runs of this premium product, designed to appeal to those who want added value in terms of packaging that is strong yet light-weight.

Trenton also was lauded for an achievement of a different sort during 1997, at ceremonies marking the first anniversary of the unique closed-loop process water system that eliminates discharges of liquid effluent from the mill. Trenton is the first integrated pulp and paper mill in North America to successfully implement this type of environmentally friendly, zero-discharge system.

GARY LANGE – RED ROCK

RAMPING UP AT RED ROCK

The revamped Red Rock, Ontario containerboard mill was a major focus of the Packaging division's energies during 1997. A $55-million expansion program, which got under way in 1996, encountered considerable difficulty in terms of delays and disruptions to production. These difficulties have now been resolved and the project was largely completed by year-end 1997, although a small additional investment will be required in order to optimize operations.

Production is being ramped up with the expectation that the mill will be able to consistently meet its output targets by the end of 1998. Although the expansion was designed to boost the mill's annual capacity by as much as 120,000 tonnes, or 40%, initial output estimates have been revised downward to reflect an expanded product mix that now includes several more-profitable, light-weight grades.

Concord plant first to gain *ISO 14000* status

FROM LEFT TO RIGHT: BILL MORRIS, JOE VASSALLO, GARRY BARFOOT, KEN CHAPMAN – CONCORD

The corrugated container plant in Concord, Ontario registered another first, when it became the first box plant in North America to meet the stringent standards required for certification under the ISO 14000 program for environmental management. The other Ontario box plants are expected to obtain certification in 1998 – a further demonstration to governments, communities and customers of the Company's commitment to operate production facilities that are first-rate in every respect.

FU CHIU – LITHOTECH

Innovative packaging designs *make winners* of Domtar – and its customers

Domtar captured seven awards, including the coveted Consumers' Choice Award, at Canada's 1997 National Packaging Competition.

The Consumers' Choice honours went to "Exoticup", a die-cut corrugated box specially conceived for shipping and displaying hand-painted pottery tea sets crafted in British Columbia by the Chloe and Isaac Dishware Studio. Two other Domtar Packaging designs received top Gold awards: Potty Soft, a unique corrugated bathroom seat for toddlers; and a five-colour, triangular-shaped Corn Cakes Club Pack developed for Quaker Oats.

While the Corporation appreciates the well-deserved recognition these awards bring to Packaging personnel, the real winners are the customers who benefit from our innovative packaging solutions.

During 1997, the division also worked to pioneer packaging solutions aimed at competing with plastics in multi-use applications. Promising developments include new super-strength, recyclable wax boxes and a new low-cost method of manufacturing coated-liner corrugated boxes.


JOHN RAMSAY – TRENTON

Lithotech provides eye-catching *artistic touch*


YVAN ROY – LITHOTECH

In a fast-paced world where shoppers typically take less than a second to scan store shelves for their selections, the Lithotech unit provides customers with a competitive edge in the form of eye-catching, attention-grabbing packaging that makes their products stand out from the crowd.

The talented team of structural designers, graphic artists and photographers at the Lithotech design centre in Scarborough, Ontario has elevated high-graphics packaging to a true art form. Their creations include custom-designed consumer and retail packaging, presentation containers, gift packs and point-of-purchase displays produced with the benefit of in-house, six-colour offset printing capability that assures vivid reproduction and consistent quality.

Advanced C-former technology at Trenton *adds value*

The Trenton corrugating medium mill is busy adapting advanced C-former technology to its semi-chemical corrugating medium line. This $3.5-million investment is expected to enable the facility to exceed its target of a 15% return on equity and allow Trenton to open up lucrative new domestic and export markets.

Corrugating medium is the "wavy" part of a carton that is sandwiched between two walls of linerboard. The C-former technology results in a much-improved final product with increased sheet uniformity and formation, providing superior runnability on paper machines and better convertibility in our customers' plants.

The benefits of this technology are not limited to customers, but are also reflected in the Company's bottom line, in terms of incremental production, increased margins and the more stable pricing environment for value-added products.

The fact that the Trenton facility is the only semi-chemical corrugating medium mill in all of North America with this technology means we are ahead of the competition in serving the market for this value-added corrugating medium.

Environment

Domtar is a staunch supporter of environmental protection in accordance with the concept of sustainable development, and is committed to continuous improvement in its environmental performance.

Recent environmental initiatives attest to Domtar's conscientious stewardship in this vital area:

- A Domtar box plant in the Toronto area is the first such facility in North America to meet the tough ISO 14000 environmental standards;
- Our Windsor, Québec facility remains the only paper mill in the world to participate in the internationally recognized Responsible Care™ program, which was developed in Canada by the Canadian Chemical Producers' Association;
- Successful implementation of the closed-loop process water system at the integrated pulp and containerboard mill in Trenton, Ontario represents another industry first in North America.

The Corporation has invested extensive sums in its effluent treatment facilities over the past few years to ensure that all of its mills exceed relevant regulatory standards. During 1997, we continued to perfect the management of those systems, which have proven very efficient since their inception.

Responsible Care.
A Total Commitment®

Innovative thinking results in award

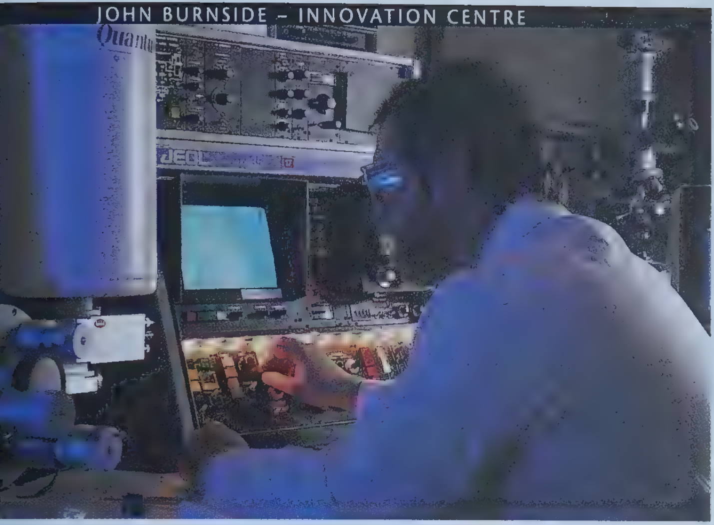
Putting waste to good use

Domtar is constantly on the lookout for new, economically viable ways to ensure optimal use of our natural resources.

In 1997, for the second consecutive year, the Cornwall, Ontario mill received an outstanding business award from the Recycling Council of Ontario for its commitment to environmental protection. The mill recycles more than 90% – or approximately 200,000 cubic metres – of the bark, biosolids and other by-products it generates annually for use as a soil conditioner on agricultural and forest lands. Similar initiatives are being undertaken at other Domtar mills.

CORNWALL

The Domtar Innovation Centre is currently working with researchers at the University of Toronto and the *Université du Québec à Trois-Rivières* to develop a wood fibre-reinforced, thermoplastic composite material made from waste and used in the manufacture of a variety of consumer products.



JOHN BURNSIDE – INNOVATION CENTRE

Reduction of odours and particulate *a priority*

Domtar has made significant progress in reducing and/or eliminating the odours and particulate emitted at its primary manufacturing facilities.

During 1997, for example, we completed a series of upgrades to the recovery boiler at our Windsor fine papers mill that has succeeded in reducing emissions of odour-producing, total-reduced sulphur (TRS) to levels that meet world standards.

A new recovery boiler installed at the Lebel-sur-Quévillon, Québec kraft pulp mill as part of a $245-million modernization program was successfully started up in June of 1997, enabling the Norkraft unit to reduce its production costs while also meeting updated standards for atmospheric emissions and odour reduction. This was followed in December by the start-up of a new, biomass-fired turbogenerator that makes the mill more energy self-sufficient and reduces its consumption of fossil fuel – another contribution by Domtar to lessen concerns regarding climate change.

We are now addressing similar issues at Cornwall, in the context of our long-term plans for that facility.

A LEADER IN RECYCLING

Recycling is another important element in terms of conserving our precious natural resources and safeguarding our environment. And, here too, Domtar has shown leadership. A Canadian pioneer in the recycling of office waste and old corrugated containers, the Company last year diverted some 565,000 tons of waste paper from landfill sites. We are also Canada's largest producer of 100% recycled printing and writing papers.

Human Resources

It is evident that human resources – not bricks, mortar and machinery – represent a company's greatest potential competitive advantage.

Domtar rightly prides itself on having plants, processes and fibre resources of high quality. However, in an era where the latest equipment and technologies quickly become available to virtually any industry player who can afford to pay, the reality is that most of our competitors have access to similar processes and production capabilities.

It is people that define the soul and culture of a company and, ultimately, represent the single most important determinant in its success or failure. People have ideas. People make those ideas work. It is people that adapt – or not – to change.

Domtar is committed to providing a working environment where our people are highly motivated and focused on creating real value. By environment, we mean everything from management style to work organization and training, from plant and equipment to safety and security procedures, from the dissemination of best practices to the pursuit of continuous improvement.

Current and planned initiatives in support of this commitment include:

- Work reorganization – such as the agreement achieved in early 1997 at the Norkraft pulp mill in Lebel-sur-Quévillon, Québec;
- The introduction of comprehensive continuous-improvement and statistical process-control programs; and
- The provision of extensive training programs focusing on performance management and the establishment of a formal succession planning process. The initial stage of performance-management training, involving first- and second-level managers, was launched in late 1997. During 1998, the program will be extended to other levels of the Corporation.

These initiatives are designed to further our goal of creating success and building value for the three stakeholders we see as fundamental to the long-term well-being of Domtar, namely:

- Customers – by consistently meeting standards for performance and quality while providing superior service;
- Shareholders – by consistently generating returns in excess of our cost of capital, thereby creating economic value added (EVA®); and
- Employees – by contributing to the sort of profitable growth that will translate into stable, safe and fulfilling jobs.

At Domtar, our guiding principle is very straightforward: The quality of an organization reflects the quality of its people. Our growth will be ensured by the training and development of our employees and their individual commitment to achieving the Company's objectives.

LOUISE RAYMOND – INNOVATION CENTRE

HEALTH AND SAFETY

Domtar considers the safety and well-being of its workers to be of paramount importance and strives for continuous improvement in this area throughout its operations. So we are pleased to report that a number of Domtar business units reached new milestones for occupational health and safety during 1997:

- In April, the Cornwall, Ontario fine papers mill set a new record by surpassing 2.4 million consecutive hours worked without a lost-time injury;

RICHARD WISER – ETOBICOKE

- In 1997, the Red Rock, Ontario linerboard mill was named the safest mill in Canada for having worked 820,000 hours, or one full year, during 1996 without a lost-time injury;
- The Moncton, New Brunswick packaging plant went 26 months without a lost-time accident, making it the second-safest facility of its kind in all of North America.

We are constantly on the lookout for ways to provide a safer working environment. During the fall of 1997, for example, Pulp and Forest Products implemented major new workplace safety programs – the "No Excuses" campaign at the Norkraft pulp mill and "Total Intolerance… A Vital Strategy" in its Québec woodlands and sawmill operations.

Because we view the health and safety record as a vital measure of a business unit's overall operational excellence, Domtar managers will bear increased responsibility for workplace safety as we intensify our focus on performance management.

CORPORATE SOCIAL RESPONSIBILITY

As a responsible corporate citizen, Domtar is well aware of the key role it has to play in developing and improving the quality of life in the communities where it is present. The Corporation believes that, by becoming a party to and a partner in the social and economic development of these communities, it can really make a difference. Accordingly, it allocates significant human and financial resources to such pursuits.

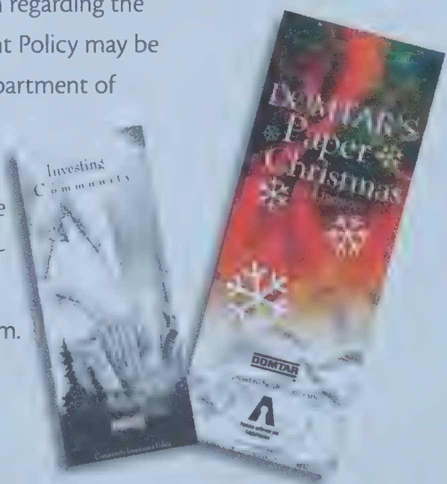
During 1997, Domtar took a new approach to its philanthropic vision, adopting a formal Community Investment Policy that focuses on three areas of primary interest:

- Education, culture and the arts;
- The environment; and
- Community involvement.

Domtar favours programs which encourage people to pursue their education; emphasize the teaching and promotion of culture; foster cultural integration; and support research in areas of particular interest to the Corporation.

For example, Domtar has created a first on the Internet by establishing an environmentally related educational site called "The World of Trees" in cooperation with a Montréal-region school board. The aim here is to increase awareness and create a greater appreciation of our forests among young people. In 1997, the Corporation also joined forces with the *Fondation québécoise pour l'alphabétisation* to mount a literacy campaign entitled Domtar's Paper Christmas for Literacy.

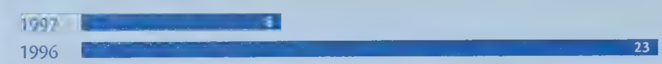
Further information regarding the Community Investment Policy may be obtained from the Department of Communications and Government Relations at Domtar's head office in Montréal, or by visiting our web site at: http://www.domtar.com.



Overview

NET EARNINGS (IN MILLIONS OF $)

NET EARNINGS BEFORE NON-RECURRING ITEMS (IN MILLIONS OF $)



During 1997, Domtar reported net earnings of $25 million ($0.15 per common share) compared to net earnings of $97 million ($0.68 per common share) in 1996. However, net earnings before non-recurring items amounted to $8 million ($0.04 per common share) in 1997 compared to $23 million ($0.12 per common share) in 1996. The non-recurring item in the 1997 results relates to a $17-million after-tax gain realized on the contribution of Domtar's Packaging net assets to Norampac Inc. ("*Norampac*"), a 50-50 joint venture formed with *Cascades Inc.* effective December 30, 1997. The after-tax impact of the 1996 non-recurring items amounted to $74 million and is discussed in the "1996 compared to 1995" section of the MD&A.

Domtar was able to remain profitable in 1997 primarily due to the realization of a major productivity and cost improvement program and lower financing expenses, despite the adverse impact of lower average prices in 1997. Business conditions for the paper industry, especially during the first half of 1997, continued to be difficult, as evidenced by the bottoming out of prices for the majority of our products during that period.

Effective December 30, 1997, Domtar and *Cascades Inc.* merged their respective container and corrugated packaging businesses to form a 50-50 joint venture. The combined assets, to be operated as one company under the name *Norampac*, will constitute a major force in the North American market and will rank as the largest Canadian manufacturer of linerboard, corrugated medium and corrugated packaging products. Domtar's Packaging business was contributed to the joint venture for a total consideration of $582 million, of which $100 million was received in cash, $280 million in common shares of *Norampac*, $200 million in redeemable preferred shares of *Norampac* (which were totally redeemed for cash on January 7, 1998) and the remainder is to be received as reimbursement of certain capital expenditures. When considering the complementary nature of the businesses contributed by each company and the significant amount of synergies to be realized by *Norampac*, it is expected that the new company will substantially enhance its competitive cost position.

The total pre-tax gain (before proportionate consolidation) that resulted from the *Norampac* transaction amounted to $196 million, of which $98 million was not recognized due to Domtar's 50% investment in the joint venture. Of the remaining $98 million, $25 million was recorded in earnings in 1997 and $73 million was deferred and will be amortized over 15 years starting in 1998.

As a result of the *Norampac* transaction, Domtar's 1997 Consolidated Earnings, Cash Flows and notes related thereto, include 100% of the operating results of its packaging division, whereas the Consolidated Balance Sheet and notes related thereto, include Domtar's 50% share of *Norampac's* assets and liabilities as at December 31, 1997.

ECONOMIC VALUE ADDED (EVA®)

The Corporation uses Economic Value Added, or EVA®, to ensure that the decision-making process at Domtar is aligned with the objective of increasing shareholder value. This concept is fully implemented throughout the Corporation since 1996 and is being used to measure performance, evaluate investment decisions and help determine, in part, incentive compensation for all non-unionized employees.

EVA® for Domtar in 1997 was $156 million negative, a decrease of $36 million compared to 1996, due to the decline in selling prices, partially offset by the positive impact of our productivity and cost improvement program and by lower cost of capital which resulted from Domtar's refinancing in 1996.

Domtar remains committed to creating long-term shareholder value and will continue to intensify its efforts in this regard

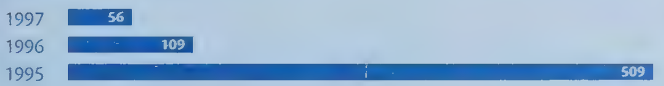
during 1998, especially in areas under its control, such as, productivity, costs, customer service and capital management.

DOMTAR EVA (IN MILLIONS OF $)

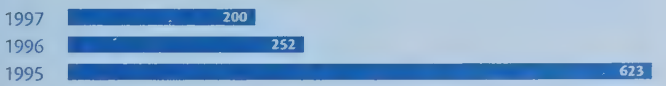
Operating results

SALES (IN MILLIONS OF $)

OPERATING PROFIT BEFORE UNUSUAL ITEM (IN MILLIONS OF $)



EBITDA BEFORE NON-RECURRING ITEMS (IN MILLIONS OF $)



OVERVIEW

During 1997, Domtar launched a productivity and cost improvement program which targeted a $50-million improvement in operating profit. Domtar was able to exceed its target by $20 million, or 40%, achieving a total of $70 million. The results of this program are comprised of $44 million resulting from volume, productivity and mix improvement initiatives and $26 million from cost reduction initiatives, net of inflation.

This performance allowed Domtar to mitigate the combined negative impact of approximately $123 million resulting from lower prices for the majority of its products and the higher secondary fibre cost and stumpage fees. As a result, operating profit before unusual item amounted to $56 million, a decrease of $53 million compared to 1996.

Net sales in 1997 totalled $1,938 million, down $39 million from 1996 net sales of $1,977 million. This decrease is mainly explained by the effect of lower selling prices in 1997, partially offset by higher shipments. Average prices for Domtar's major products were 1% to 15% lower than in 1996, despite several price increases which were implemented during the second half of the year and the fact that year-end prices for most of our products were higher than those at the end of 1996. As a result of our productivity and cost improvement program, shipments in 1997 increased by 2% to 10% for all of our products except lumber, which decreased by 11%, primarily due to a temporary shutdown at the Grand-Remous, Québec sawmill following a labour disagreement.

Cost of sales increased by $24 million in 1997 compared to 1996, due to higher shipments, higher wood fibre costs due to stumpage fee increases, increased non-recurring production costs upon start-up of equipment, as well as increased costs of purchased secondary fibre. The negative impact of these elements was partially offset by notable operational improvements at the majority of Domtar's manufacturing facilities, which is additional evidence of the benefits that resulted from the productivity and cost improvement program.

Selling, general and administrative expenses decreased by $11 million in 1997 compared to 1996, primarily due to a decrease in required environmental expenditures.

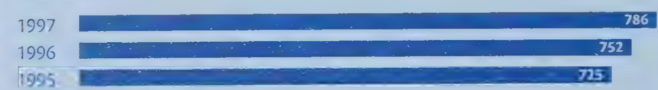
Earnings before financing expenses, income taxes and amortization (EBITDA) before non-recurring items were $200 million in 1997 compared to $252 million in 1996.

Operating profit in 1997 did not include any unusual item, whereas in 1996, a $35-million unusual charge, principally related to asset write-downs at the specialty and securities fine paper mills in Cornwall, Ontario and Beauharnois, Québec, was recorded.

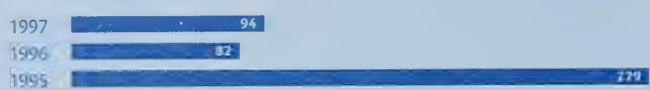
FINE PAPERS

SALES (IN MILLIONS OF $)

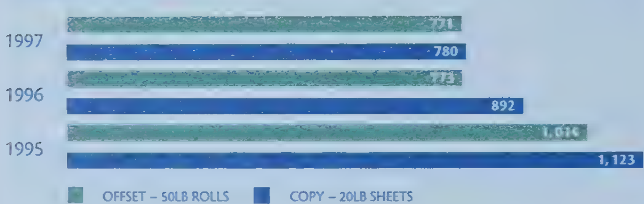
SHIPMENTS (IN '000 TONS)



OPERATING PROFIT (IN MILLIONS OF $)



AVERAGE LIST PRICES (IN U.S.$/TON)



Net sales in the Fine Papers segment amounted to $1,052 million in 1997, a decrease of $9 million, or 1%, compared to 1996. This decrease was due to lower selling prices mainly in the first half of 1997, partially offset by a 5% increase in shipments from Domtar's mills.

Operating profit for 1997 amounted to $94 million, an increase of $12 million, or 15%, compared to 1996, mainly as a result of the impact of the productivity and cost improvement program, partially offset by lower prices.

Further productivity gains were achieved at all three fine paper mills in 1997, as efforts continued to improve our cost competitiveness. The Windsor, Québec mill continued to achieve high productivity levels in 1997. At the Cornwall, Ontario mill, despite the shutdown of two (2) paper machines in mid-1996, paper machine average production reached 708 tons per day in 1997 compared to 664 tons per day in 1996.

In the first quarter of 1997, relatively high industry inventories caused selling prices to drop below the already depressed prices experienced at the end of 1996. During the second quarter of 1997, demand gradually exceeded supply, which allowed for the partial implementation of a U.S.$80/ton price increase on offset paper and a U.S.$40/ton price increase on copy paper. During the third quarter of 1997, the traditional slowdown normally experienced in the summer months did not occur and demand continued to improve, allowing for futher price increases to materialize. The list price of 50lb offset rolls averaged U.S.$771/ton in 1997, essentially unchanged compared to 1996. The list price of 20lb copy paper averaged U.S.$780/ton in 1997, down 13% on average from 1996.

WINDSOR

CORNWALL

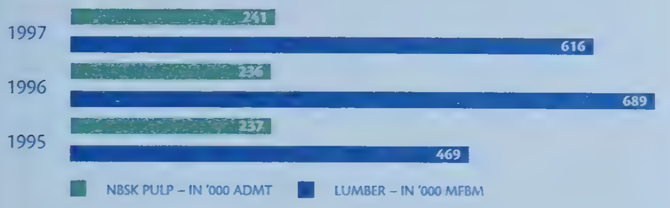
Pricing in 1998 should continue to show improvement, as evidenced by the U.S.$50/ton price increase on offset paper and the U.S.$40/ton price increase on copy paper implemented early in 1998. However, this assumes supply/demand dynamics will remain favourable.

PULP AND FOREST PRODUCTS

SALES

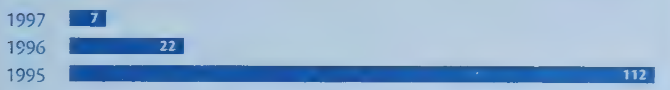
(IN MILLIONS OF $)

SHIPMENTS

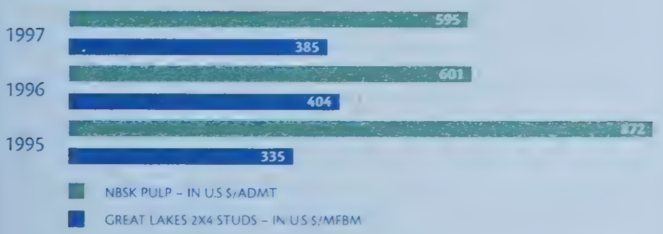


OPERATING PROFIT

(IN MILLIONS OF $)



AVERAGE LIST PRICES



Combined net sales of pulp and lumber amounted to $408 million, a decrease of $18 million, or 4%, compared to 1996, primarily due to decreased lumber shipments and lower selling prices for lumber and wood chips. Higher stumpage fees was the main factor that contributed to the $15-million decrease in operating profit compared to 1996.

Pricing for Northern Bleached Softwood Kraft (NBSK) pulp remained stable throughout the first half of 1997. Following an NBSK pulp price increase of U.S.$30/tonne on July 1, 1997, prices remained firm with attempts to introduce further increases proving largely unsuccessful. Overall, the 1997 average list price of NBSK pulp was U.S.$595/tonne, essentially unchanged from 1996.

In 1997, significant progress was made at the Lebel-sur-Quévillon, Québec pulp mill. Construction work on the $245-million modernization project, which began in 1995, was completed and the start-up of the new recovery boiler was successful. This will bring annual production capacity at this mill to 280,000 air dried metric tons (ADMT). In addition, existing environmental regulations have been met and the new turbo-generator is in commercial operation since December 1997. This will result in significant cost reductions at the mill, especially in the energy area.

LEBEL-SUR-QUÉVILLON

The recent difficulties experienced in the Asian markets are creating uncertainty on worldwide markets in early 1998. However, strong demand for paper could support pulp prices unless the economic conditions prevailing in Asia persist throughout 1998.

Market conditions for lumber remained favourable through the first half of 1997 and prices remained relatively high, supported by strong U.S. demand and an improvement in Canadian demand. However, markets weakened during the fourth quarter of 1997, as exports were repatriated into North America due to weak Japanese and other Asian markets. Overall, the average price for Great Lakes 2x4 Kiln Dried studs dropped from U.S.$404/MFBM (thousand board feet) in 1996 to U.S.$385/MFBM in 1997. However, the overall net realization for lumber at our sawmills remained relatively unchanged from 1996 due to the successful implementation of quota management and product and customer mix initiatives.

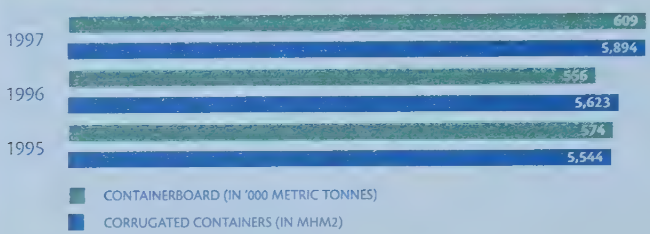
Softwood lumber markets may weaken further in 1998. Although Canadian housing starts continue to show improvements, U.S. and overseas housing starts are expected to weaken and additional export volumes may be repatriated into North America, negatively affecting the supply and demand balance. This, combined with the continued strength of the U.S. dollar, may put a downward pressure on softwood lumber prices in 1998. However, at current prices, some producers, especially in western Canada, have already surpassed their quota allocation

and are taking downtime to avoid cash losses, possibly putting a floor on further price declines.

PACKAGING

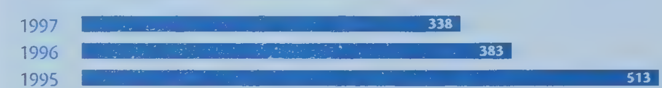
SALES (IN MILLIONS OF $)

SHIPMENTS



OPERATING PROFIT (LOSS) (IN MILLIONS OF $)

AVERAGE LIST PRICE – LINERBOARD 42 LB (IN U.S.$/TON)



Net sales for the Packaging segment totalled $478 million, a decrease of $12 million, or 2%, compared to 1996, due to lower selling prices, partially offset by an increase in shipments.

The operating loss for 1997 amounted to $45 million compared to an operating profit of $5 million in 1996. This $50-million decrease is largely due to substantially lower selling prices, especially for linerboard which bottomed out at U.S.$285/ton mid-1997, and increased cost of purchased secondary fibre. The cost of old corrugated containers, which averaged only U.S.$45/ton in 1996, averaged U.S.$72/ton in 1997.

Total shipments in 1997 increased by 10% for containerboard and by 5% for corrugated containers compared to 1996, as a result of the additional capacity at the Red Rock, Ontario mill in the second half of the year and stronger demand for corrugated containers.

During 1997, the expansion project at the Red Rock mill did not achieve the anticipated improvements until the fourth quarter of 1997. At the Mississauga, Ontario mill, the successful installation of a $10-million shoe press during the third quarter of 1997 yielded significant operational improvements.

Containerboard markets which had deteriorated during 1996, weakened further during most of the first half of 1997. The first signs of improvement, however, occurred late in the second quarter of 1997, following a recovery of corrugated container shipments. This resulted in a U.S.$40/ton price increase for corrugated medium in the second quarter and was followed by the successful implementation of a further U.S.$40/ton and U.S.$50/ton price increases on both linerboard and corrugated medium during the latter half of 1997. Despite these price increases, the 1997 average containerboard list price was U.S.$338/ton, down 12% compared to the 1996 average of U.S.$383/ton. The selling prices for corrugated containers followed the improving trend but lagged behind the containerboard market, with the majority of the price increases realized late in 1997 and expected to continue to be realized into the first quarter of 1998.

In 1998, demand is expected to be positive due to the continued strength of the North American economy coupled with little new capacity which should result in an improved supply-demand balance. While the upswing in prices may be impacted to a certain extent by the recent economic instability in Asia, it is believed that its effect will be lessened by the strong North American supply/demand balance and the renewed interest in virgin fibre.

Other expenses

FINANCING EXPENSES

During 1997, financing expenses charged against earnings, net of interest income, were $50 million, a $22-million decrease compared to 1996, as a result of lower net debt levels arising from the comprehensive refinancing program completed in 1996, partially offset by lower income earned from short-term investments.

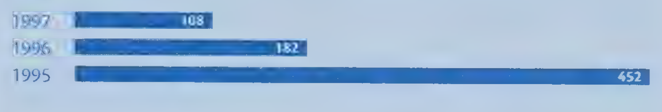
INCOME TAXES AND OTHER LEVIES

The income tax expense of $8 million for 1997 represents an effective tax rate of 25.8% compared to 29.6% in 1996. This reduction in rate is primarily due to the tax rate differential resulting from the drawdown of deferred tax liability.

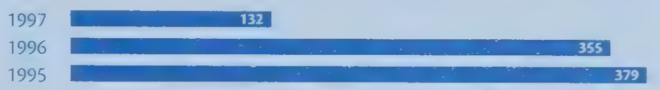
Domtar is also subject to various other taxes and government levies amounting to $92 million in 1997 which are comprised, among other things, of payroll, municipal and school taxes and stumpage fees.

Liquidity and capital resources

NET CASH FLOW FROM CONTINUING OPERATIONS (IN MILLIONS OF $)



CAPITAL EXPENDITURES (IN MILLIONS OF $)



CASH FLOW BEFORE FINANCING (IN MILLIONS OF $)

NET DEBT-TO-TOTAL-CAPITALIZATION PERCENTAGE

In 1997, Domtar generated net cash flow from continuing operations of $108 million, compared to $182 million in 1996. The decrease was mainly due to lower selling prices for Domtar's products as explained previously, and higher working capital.

Cash flow before financing in 1997 was lower by $148 million compared to 1996, as a result of, among other things, the $300 million of net proceeds from the contribution of Domtar's Packaging business to *Norampac*, compared to the $604 million of net proceeds from the divestiture of the Gypsum and Decorative Panels businesses in 1996. In addition, capital expenditures, including capitalized interest, amounted to $132 million in 1997, a decrease of $223 million compared to 1996. Capital investments in 1997 were reduced due to difficult market conditions. Domtar maintains a policy of limiting its capital expenditures to the maximum of the sum of depreciation plus 50% of after-tax profit.

As at December 31, 1997, the Corporation's total long-term debt, including its 50% share of the indebtedness of *Norampac* ($206 million), net of the net cash position, was $626 million compared to $613 million as at December 31, 1996. The long-term debt of *Norampac* is not guaranteed by Domtar. Coincident with the contribution of the Packaging net assets to *Norampac*, amounts available under Domtar's line of credit were reduced from $450 million to $400 million. As at December 31, 1997, the $400-million bank credit facility was undrawn while letters of credit totalling $14 million were outstanding. As at December 31, 1996, letters of credit totalling $14 million and no borrowings were outstanding under the $450-million bank credit facility in effect at that time.

As at December 31, 1997, the Corporation's net debt-to-total-capitalization percentage was 33%, compared to 32% as at December 31, 1996. The $300 million proceeds from the contribution to *Norampac* were partly used to repay all bank borrowings outstanding ($100 million).

1996 compared to 1995

OVERVIEW

Business conditions for the paper industry during 1996 were difficult, as market conditions were characterized by a rapid decline in pricing through the first half of the year with little or no improvement during the second half. As a result, Domtar realized net earnings of $97 million ($0.68 per common share) in 1996 compared to record net earnings of $304 million ($2.32 per common share) in 1995.

Excluding the non-recurring items mentioned below, earnings from continuing operations amounted to $23 million ($0.12 per common share) in 1996 compared to $239 million ($1.80 per common share) in 1995.

Results for 1996 included three non-recurring items which had a significant impact on net earnings:

- A $172-million after-tax gain on the divestitures of the Gypsum and Decorative Panels divisions and $12 million of net earnings from these discontinued businesses.
- A $127-million charge ($87 million after-tax) related to the refinancing program completed during the year, consisting of the premium on the early repayment of debt, together with the write-off of deferred debt issue expenses and exchange losses.
- A $35-million unusual charge ($23 million after-tax) principally related to the write-down of certain assets at the fine paper mills in Cornwall, Ontario and Beauharnois, Québec.

OPERATING RESULTS

Sales in 1996 decreased 10% compared to 1995 due to a significant decline in pricing for most of Domtar's products, following record levels achieved in 1995. With the exception of lumber, prices for all of Domtar's major products were significantly lower than in 1995. This was the primary reason for the $400-million decrease in operating profit before unusual item compared to 1995.

Shipments in 1996 were essentially unchanged in comparison to 1995, with the exception of lumber. Shipments of lumber increased by 47% due to increased demand and additional production capacity, following the acquisition of sawmills in the second half of 1995. This favourably affected operating results.

Cost of sales increased by $139 million in 1996 compared to 1995, due to increased lumber production, higher wood fibre costs due to stumpage fee increases and other government levies, increased production costs mainly due to start-up inefficiencies following capital investment projects, as well as higher employee training costs. Ongoing operating costs also increased due to infrastructure costs associated with the secondary effluent treatment facilities completed in 1995. These cost increases were partially offset by lower costs for purchased pulp and old corrugated containers.

Amortization costs increased by $29 million compared to 1995 due to capital investment projects completed in 1995, including secondary effluent treatment facilities, as well as businesses acquired in 1995.

FINE PAPERS

The Fine Papers segment suffered a $179-million, or 14%, decrease in sales compared to 1995, mainly due to significantly lower selling prices. The impact of the lower selling prices was partially offset by a 4% increase in shipments from the mills

and increased sales contribution from *La Compagnie J.B. Rolland et Fils*, which was acquired in the third quarter of 1995. Operating profit decreased by $197 million, mainly as a result of the lower selling prices.

During the fourth quarter of 1995, demand for fine papers started to weaken, largely driven by destocking at every point in the paper chain and a slowdown in economic growth. Market conditions further deteriorated in the first quarter of 1996, with the continued drop in demand leading to sharp declines in selling prices. Attempts to increase prices in the second half of the year proved unsuccessful.

Overall, the list price of 50lb offset rolls averaged U.S.$773/ton in 1996, down 24% compared to 1995. Similarly, the list price of 20lb copy paper averaged U.S.$892/ton in 1996, down 21% compared to 1995.

PULP AND FOREST PRODUCTS

Combined sales of pulp and lumber increased by $67 million, or 19%, compared to 1995, as increased shipments and selling prices for lumber more than offset the impact of significantly lower pulp selling prices.

The sharp drop in pulp selling prices, combined with higher operating costs due to increased stumpage fees and other governmental levies, start-up difficulties at two sawmills and mechanical failures at the pulp mill in Lebel-sur-Quévillon, Québec, more than offset the impact of increased lumber selling prices and shipments, and resulted in a $90-million decrease in operating profit compared to 1995.

In the pulp business, the abrupt decline in the price of NBSK pulp, which began in December of 1995, continued in the first half of 1996. Overall, the 1996 average list price of NBSK pulp was U.S.$601/tonne, down 31% compared to 1995.

Lumber was the only business where market conditions were more favourable than in 1995. In 1996, demand for lumber increased because of lower interest rates, strong U.S. economic growth and higher housing starts. This led to a 21% increase in the average selling price of Great Lakes 2x4 Kiln Dried studs compared to 1995. The implementation of the new quota system for Canadian softwood lumber exports to the United States also favourably affected pricing in 1996.

In 1996, favourable market conditions combined with increased production, following the acquisition of sawmills during the second half of 1995, resulted in a 47% increase in lumber shipments compared to 1995.

PACKAGING

Sales of the Packaging segment decreased by $117 million, or 19%, compared to 1995, due to significantly lower selling prices.

Overall, shipments in 1996 were almost unchanged compared to 1995; containerboard trade shipments fell by 4% while shipments of corrugated containers increased by 1%.

Operating profit for 1996 decreased by $113 million compared to 1995, largely due to lower selling prices, partially offset by a significant decrease in the cost of purchased secondary fibre. The cost for old corrugated containers averaged only U.S.$45/ton compared to U.S.$121/ton in 1995. During 1996, lower productivity and increased maintenance costs at the kraft linerboard mill in Red Rock, Ontario also contributed to the decline in operating profit.

Containerboard markets which began to deteriorate during the second half of 1995, further deteriorated during the first half of 1996. Overall, the 1996 average linerboard list price was U.S.$383/ton, down 25% compared to the 1995 average. Selling prices for corrugated containers followed this trend and shrinking margins in this business also affected the profitability of the Packaging segment in 1996.

FINANCING EXPENSES

During 1996, financing expenses charged against earnings, net of interest income, were $72 million, a $51-million decrease compared to 1995. The major items contributing to this net decrease were as follows:

- As a result of the refinancing program completed in the third quarter of 1996, interest expense on long-term debt declined by $27 million and amortization of deferred debt issue expenses and exchange losses decreased by $13 million.
- Capitalized interest increased by $7 million in 1996 compared to 1995, due to increased expenditures for the modernization project at the pulp mill in Lebel-sur-Quévillon, Québec and expenditures made with respect to the capacity expansion project at the kraft linerboard mill in Red Rock, Ontario.

- In 1995, the Corporation incurred a \$5-million foreign exchange loss on the repayment of its revolving bank credit facility denominated in U.S. dollars.
- As a result of the conversion of the 8% convertible debentures in September 1996, the interest expense related to the convertible debentures decreased from \$8 million in 1995 to \$5 million in 1996.
- Income earned from short-term investments and short-term deposits held in trust decreased by \$3 million compared to 1995. This decrease was due to the combined effect of a lower average net cash position for the Corporation in 1996 compared to 1995 and falling interest rates during 1996.

INCOME TAXES AND LEVIES

The income tax recovery of \$37 million represented an effective tax rate of 29.6% compared to 36.5% in 1995. The most important factor contributing to this reduction was the Canadian Large Corporations Tax, which, although it was approximately the same in both years, represented a greater proportion of the total taxes in 1996 because of the lower level of earnings.

Domtar is also subject to various other taxes and government levies amounting to \$84 million, which are comprised, among other things, of payroll, municipal and school taxes and stumpage fees.

Risk and opportunities

FOREIGN EXCHANGE RISK AND MANAGEMENT

In accordance with its policies, the Corporation has only limited involvement with derivative financial instruments and does not enter into transactions for speculative purposes. The Corporation has in place a policy, approved by its Board of Directors, for hedging the value of future U.S. dollar receipts for periods of up to three years in order to reduce the potential negative effect of a rising Canadian dollar. The Corporation has entered into various hedging arrangements as detailed in Note 14 to the Consolidated Financial Statements of Domtar Inc. For 1998, hedging contracts are in place that would protect the value of part of Domtar's expected net U.S. dollar cash inflows at a rate of \$1.31, while limiting the potential benefit of a higher-valued U.S. dollar for part of Domtar's U.S. dollar cash inflows at a rate of \$1.36.

A significant proportion of Domtar's sales is sensitive to the value of the U.S. dollar relative to the Canadian dollar, including sales of many of its products in Canada. Domtar estimates that a one-cent change in the value of the Canadian dollar would affect operating results by approximately \$18 million annually, based on year-end product prices, before taking into account any effect of hedging instruments.

In 1997, the U.S. dollar averaged \$1.38 Canadian, compared to an average of \$1.37 Canadian for 1996.

ENVIRONMENTAL MATTERS

Domtar is subject to stringent industry-specific environmental laws and regulations imposed by federal and provincial (state) authorities in Canada and in the United States. In 1997 and 1996, Domtar spent \$5 million and \$52 million, respectively, to complete environmental projects linked to water and air regulations.

In 1998, Domtar estimates that approximately \$16 million in additional capital expenditures, including its 50% share of *Norampac* of \$3 million, will be spent on environmental projects, including expenditures to address environmental compliance with some provincial air emission standards.

Domtar is continuing to take remedial action at a number of current and former sites, due to possible soil, sediment or groundwater contamination. As at December 31, 1997, Domtar had a provision of \$45 million for known and determinable site rehabilitation costs, primarily in connection with the former wood preserving and gypsum businesses. Furthermore, Domtar is party to some environmental claims, actions, charges and lawsuits which are being contested. The process of investigation and remediation can be lengthy and is subject to the uncertainties of changing legal requirements, developing technologies and the allocation of liability among potentially responsible parties.

YEAR 2000 ISSUE

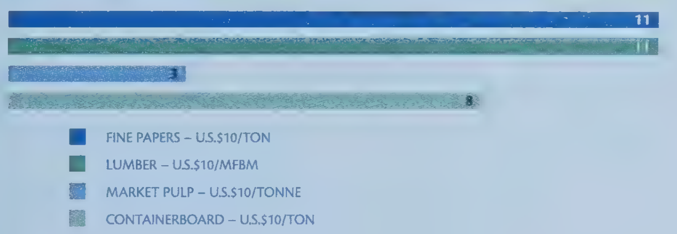
During 1997, Domtar completed the review of the systems critical to its on-going operations and preparation of financial information and also completed the assessment of the impact that the year 2000 will have on the accuracy of the systems'

calculations, processing and reporting. As a result, plans have been developed and are being put in place to enhance systems to ensure compliance with the year 2000 issue.

SENSITIVITY ANALYSIS

Domtar's operating results are sensitive, among other things, to fluctuations in the prices of certain commodity products. The illustration presents the estimated annual impact on operating results of a U.S.$10 per unit fluctuation, at an average exchange rate of $1.40 for U.S.$1.00 and at estimated 1998 total shipment levels, on prices of selected products sold by Domtar and *Norampac*.

IMPACT ON OPERATING RESULTS (IN MILLIONS OF CANADIAN DOLLARS)



OUTLOOK FOR 1998

North American economies are basically strong. As a result, Domtar should experience good demand from its North American customers. Pricing outlook could be affected to a certain extent by the economic conditions prevailing in Asia and by the price of pulp. However, price increases implemented for copy and offset papers early in 1998 provide us with a good indication that economic fundamentals remain strong.

In a business environment where prices may fluctuate, it is imperative to be a low-cost producer. Therefore, Domtar continues to focus on reducing costs, improving manufacturing efficiencies and customer satisfaction while maintaining a prudent capital structure. The recent joint venture with *Cascades Inc.*, with respect to our Packaging operations, will allow Domtar to optimize the value of its Packaging business and benefit from significant synergies. For fine papers, operational improvements will continue to be pursued at Windsor, Québec and at Cornwall and St. Catharines, Ontario. For pulp and forest products, the pulp mill at Lebel-sur-Quévillon, Québec will experience a full year of operations in 1998 after completion of the modernization program in 1997. The sawmills are also engaged in programs to minimize fibre utilization, improve production efficiencies and develop value-added products. All of the above should translate into productivity and cost improvements in 1998, in addition to the $70 million realized in 1997.

Domtar's financial flexibility is excellent in the aftermath of the packaging joint venture transaction, which allowed Domtar to finish the year with $283 million of cash and cash equivalents. This should allow Domtar to consider growth opportunities as they arise while maintaining a prudent financial structure. Any such growth opportunities must be structured to provide superior value creation to our shareholders.

COMMON STOCK PRICES

Quarterly share prices for the common shares of Domtar during 1997 and 1996 were as follows:

	1st	2nd	3rd	4th
1997				
Market price				
Toronto and Montréal stock exchanges				
High	**$ 12.80**	**$ 12.50**	**$ 13.50**	**$ 12.20**
Low	**10.25**	**9.50**	**11.20**	**8.85**
New York Stock Exchange (U.S.$)				
High	**9.50**	**8.875**	**10.00**	**9.25**
Low	**7.625**	**6.875**	**8.063**	**6.50**
1996				
Market price				
Toronto and Montréal stock exchanges				
High	$ 11.625	$ 10.90	$ 11.75	$ 12.70
Low	9.00	9.50	9.45	10.85
New York Stock Exchange (U.S.$)				
High	8.50	8.00	8.50	9.50
Low	6.625	6.75	6.875	7.125

FIVE-YEAR CUMULATIVE TOTAL RETURNS
Value of $100 invested on December 31, 1992

MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The consolidated financial statements contained in this Annual Report are the responsibility of management and have been prepared in accordance with generally accepted accounting principles. Where necessary, management has made informed judgments and estimates of the outcome of events and transactions, with due consideration given to materiality. Management is also responsible for all other information in the Annual Report and for ensuring that this information is consistent, where appropriate, with the information and data included in the financial statements.

In support of its responsibility, management maintains a system of internal control to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Corporation's external auditors are responsible for auditing the financial statements and giving an opinion thereon. In addition, the Corporation maintains a staff of internal auditors whose functions include reviewing internal controls and their application, on an ongoing basis.

The Board of Directors carries out its responsibility relative to the consolidated financial statements principally through its Audit Committee, consisting solely of outside directors, which reviews the financial statements and reports thereon to the Board. The Committee meets periodically with the external auditors, internal auditors and management to review their respective activities and the discharge of each of their responsibilities. Both the external auditors and the internal auditors have free access to the Committee, with or without management, to discuss the scope of their audits, the adequacy of the system of internal control and the adequacy of financial reporting.

Raymond Royer
President and Chief Executive Officer

Daniel Denault
Vice-President, Finance

AUDITORS' REPORT

To the Shareholders of
Domtar Inc.

We have audited the consolidated balance sheets of Domtar Inc. as at December 31, 1997 and 1996 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended December 31, 1997. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Domtar Inc. as at December 31, 1997 and 1996 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1997 in accordance with generally accepted accounting principles in Canada.

Price Waterhouse
Chartered Accountants

Raymond Chabot Martin Paré
General Partnership
Chartered Accountants

Montréal, Québec
January 22, 1998

CONSOLIDATED EARNINGS

Year ended December 31

(in millions of Canadian dollars, except per share amounts)

	1997	1996	1995
Sales	$ 1,938	$ 1,977	$ 2,206
Operating expenses			
Cost of sales	1,615	1,591	1,452
Selling, general and administrative *(Note 12)*	123	134	131
Amortization	144	143	114
	1,882	1,868	1,697
Operating profit before unusual item	56	109	509
Unusual item *(Note 2)*	–	35	–
Operating profit	56	74	509
Financing expenses *(Note 3)*	50	72	123
Premium and write-off on early redemption of long-term debt	–	127	–
Gain on contribution to Norampac *(Note 16)*	(25)	–	–
Earnings (loss) from continuing operations before income taxes and non-controlling interest	31	(125)	386
Income taxes *(Note 4)*	8	(37)	141
Earnings (loss) from continuing operations before non-controlling interest	23	(88)	245
Non-controlling interest	(2)	(1)	6
Earnings (loss) from continuing operations	25	(87)	239
Earnings from discontinued operations, including a net gain on divestitures of $172 in 1996 *(Note 5)*	–	184	65
Net earnings	25	97	304
Dividend requirements of preferred shares	2	3	5
Interest on equity element of convertible debentures	–	3	4
Net earnings applicable to common shares	$ 23	$ 91	$ 295
Per common share *(Note 13)*			
Earnings (loss) from continuing operations			
Basic	$ 0.15	$ (0.69)	$ 1.80
Fully diluted	*	*	1.41
Net earnings			
Basic	$ 0.15	$ 0.68	$ 2.32
Fully diluted	*	0.63	1.80

** No dilution or antidilutive*

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEET

December 31

(in millions of Canadian dollars)

		1997		1996
Assets				
Current assets				
Cash	$	9	$	–
Short-term investments		274		44
Receivables, net of allowance for doubtful accounts of $7 (1996 – $7)		242		246
Inventories *(Note 6)*		312		338
Prepaid expenses		13		9
		850		637
Investments and advances		43		39
Property, plant and equipment *(Note 7)*		1,954		1,982
Other assets *(Note 8)*		115		51
	$	2,962	$	2,709
Liabilities and shareholders' equity				
Current liabilities				
Bank indebtedness	$	35	$	20
Trade and other payables *(Note 9)*		333		345
Income and other taxes payable		18		29
Long-term debt due within one year *(Note 10)*		22		14
		408		408
Long-term debt *(Note 10)*		852		623
Deferred credits		116		57
Deferred income taxes *(Note 4)*		212		210
Other liabilities *(Note 11)*		68		91
Non-controlling interest		5		8
Shareholders' equity				
Preferred shares *(Note 13)*		100		103
Common shares *(Note 13)*		868		872
Retained earnings		333		337
		1,301		1,312
	$	2,962	$	2,709

The accompanying notes are an integral part of the consolidated financial statements.

Approved by the Board:

Jacques Girard

Jacques Girard, Director

Raymond Royer

Raymond Royer, Director

CONSOLIDATED CASH FLOWS

Year ended December 31

(in millions of Canadian dollars)

	1997	1996	1995
Operating activities			
Earnings (loss) from continuing operations	$ 25	$ (87)	$ 239
Non-cash items:			
Amortization	144	143	114
Deferred income taxes	2	(44)	135
Premium and write-off on early redemption of long-term debt	–	127	–
Write-down of assets	–	35	–
Gain on contribution to Norampac *(Note 16)*	(25)	–	–
Other	(9)	10	35
Interest payments on convertible debentures	–	(12)	(12)
Cash flow provided by continuing operations	137	172	511
Cash provided by (invested in) continuing operations working capital *(Note 17)*	(29)	10	(59)
Net cash flow from continuing operations	108	182	452
Net cash flow from discontinued operations	–	(10)	74
Net cash provided by operating activities	108	172	526
Investing activities			
Additions to property, plant and equipment	(132)	(355)	(379)
Disposal of property, plant and equipment	2	4	12
Acquisition of businesses *(Note 20)*	–	–	(88)
Consideration received upon contribution to Norampac, net of share of Norampac's bank indebtedness of $15 *(Note 16)*	285	–	–
Net proceeds from business divestitures	–	604	–
Short-term deposits held in trust	–	–	226
Other	1	(19)	7
Cash provided by (used for) investing activities	156	234	(222)
Dividend payments	(23)	(17)	(5)
Cash flow before financing activities	241	389	299
Financing activities			
Change in revolving bank credit	–	–	(89)
Long-term debt repaid	(4)	(786)	(29)
Long-term debt issued, net of expenses	–	367	–
Premium on early redemption of long-term debt	–	(83)	–
Convertible debentures converted *(Note 13)*	–	(150)	–
Common shares repurchased, net of expenses and shares issued *(Note 13)*	(10)	143	4
Preferred shares redeemed	(3)	(110)	(2)
Cash used for financing activities	(17)	(619)	(116)
Increase (decrease) during the year	224	(230)	183
Net cash position at beginning of year	24	254	71
Net cash position at end of year	$ 248	$ 24	$ 254
Represented by:			
Cash	$ 9	$ –	$ 4
Short-term investments	274	44	282
Bank indebtedness	(35)	(20)	(32)
	$ 248	$ 24	$ 254

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED RETAINED EARNINGS

Year ended December 31
(in millions of Canadian dollars)

	1997	1996	1995
Retained earnings (deficit) at beginning of year	**$ 337**	$ 265	$ (31)
Net earnings	**25**	97	304
Cash dividends declared on common shares	**(21)**	(19)	–
Cash dividends declared on preferred shares	**(2)**	(3)	(5)
Interest on equity element of convertible debentures, net of income taxes	**–**	(3)	(4)
Discount on redemption of preferred shares	**–**	3	1
Discount on conversion of convertible debentures	**–**	3	–
Premium on purchase for cancellation of common shares	**(6)**	(6)	–
Retained earnings at end of year	**$ 333**	$ 337	$ 265

The accompanying notes are an integral part of the consolidated financial statements.

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are expressed in Canadian dollars and have been prepared in accordance with accounting principles generally accepted in Canada which, in the case of Domtar, differ in certain respects from those in the United States as explained in Note 22.

Basis of consolidation

The consolidated financial statements include the accounts of Domtar Inc. (the Corporation) and all its subsidiaries (collectively, Domtar). Investments over which the Corporation exercises significant influence are accounted for by the equity method. The Corporation's interest in Norampac Inc. (Norampac), a joint venture, is accounted for by the proportionate consolidation method.

Use of estimates

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles and, as such, include amounts based on informed estimates and judgments of management with consideration given to materiality. Actual results could differ from those estimates.

Translation of foreign currencies

The gains and losses resulting from the translation of foreign currency transactions are included in earnings, except for those on long-term debt denominated in foreign currency. For such debt, exchange gains and losses are deferred and amortized over the remaining term of the related obligation.

The Corporation manages its foreign exchange exposure on anticipated U.S. dollar sales through the use of options and forward contracts. Resulting gains and losses are recognized when realized and are included in sales. The cost of options is amortized over the hedging period and is also included in sales.

Short-term investments

Short-term investments are stated at the lower of cost and market value and include instruments with original maturities of one year or less.

Inventories

Inventories of operating and maintenance supplies and raw materials are valued at the lower of average cost and replacement cost. Work in process and finished goods are valued at the lower of average cost and net realizable value and include the cost of raw materials, direct labour and manufacturing overhead expenses.

Property, plant and equipment

Property, plant and equipment is stated at cost. Interest costs are capitalized on additions to property, plant and equipment which are in excess of $10 million and for which the period of construction exceeds one year. The interest rate used is equal to the weighted average of the effective interest rates on long-term debt. Assets under construction represent those additions to property, plant and equipment on which interest costs are capitalized.

For timber limits, amortization is provided on the unit of production method. For all other assets, amortization is provided on the straight-line method using rates based on the estimated useful lives of the assets which are generally as follows:

Buildings	Up to 40 years
Machinery and equipment	Up to 20 years

The amortization expense is reported net of the amount of the amortization of deferred credits related to government grants and investment tax credits. No amortization is recorded on assets under construction.

Other assets

Other assets are recorded at cost. Preproduction costs, including training and start-up expenses, on projects in excess of $75 million are deferred and amortized on a straight-line basis over a five-year period commencing with the start-up of commercial operations. Expenses incurred in issuing long-term debt are deferred and amortized on a straight-line basis over the term of the related obligation. Goodwill and other assets, if applicable, are amortized on a straight-line basis over periods not exceeding twenty-five years. The Corporation assesses at each balance sheet date whether there has been a permanent impairment in the value of goodwill. This is accomplished mainly by determining whether projected undiscounted future cash flows from operations exceed the net book value of goodwill as of the assessment date.

Deferred credits

Deferred credits comprise government grants and investment tax credits earned in acquiring property, plant and equipment, net interest rate hedging gains on long-term debt and a deferred gain on the contribution of net assets to Norampac. Government grants and investment tax credits are amortized on the same basis as the related property, plant and equipment, while net interest rate hedging gains are amortized on a straight-line basis over the term of the related debt. The deferred gain on the contribution of net assets to Norampac is amortized on a straight-line basis over 15 years. Deferred credits are reported net of accumulated amortization.

Environmental costs

Environmental expenditures, including site rehabilitation costs, are expensed or capitalized depending upon their future economic benefit. Expenditures which prevent future environmental contamination are capitalized and amortized on a straight-line basis over a 15-year period. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when rehabilitation efforts are likely to occur and the costs can be reasonably estimated.

Income taxes

Deferred income taxes result primarily from timing differences between the amortization claimed for income tax purposes and amounts recorded for financial statement purposes, and from the tax effect of losses carried forward.

The Corporation does not provide for income taxes on undistributed income of foreign subsidiaries as such income is being reinvested in foreign operations.

(in millions of Canadian dollars, unless otherwise noted)

2. UNUSUAL ITEM

During 1996, the Corporation provided for $35 million of costs relating to the restructuring of its specialty fine papers operations, consisting primarily of asset write-downs.

3. FINANCING EXPENSES

	1997	1996	1995
Interest on long-term debt	$ 67	$ 95	$ 122
Interest on debt element of convertible debentures	–	5	8
Amortization of deferred debt issue expenses and exchange losses	4	6	19
Write-off of deferred exchange losses on the repayment of the revolving bank credit	–	1	5
	71	107	154
Less: Income from short-term investments and short-term deposits held in trust	1	19	22
Amount capitalized	20	16	9
	$ 50	$ 72	$ 123

Cash payments for interest, net of interest income and amount capitalized, totalled $44 million in 1997 (1996 – $82 million; 1995 – $103 million).

4. INCOME TAXES

The following summarizes Domtar's income taxes on earnings of its Canadian and foreign continuing operations:

	Canada			Foreign			Total		
	1997	1996	1995	1997	1996	1995	1997	1996	1995
Earnings (loss) from continuing operations before income taxes and non-controlling interest	$ 22	$ (127)	$ 378	$ 9	$ 2	$ 8	$ 31	$ (125)	$ 386
Income taxes									
Current	4	7	5	2	–	1	6	7	6
Deferred	2	(44)	135	–	–	–	2	(44)	135
	6	(37)	140	2	–	1	8	(37)	141
Earnings (loss) from continuing operations before non-controlling interest	$ 16	$ (90)	$ 238	$ 7	$ 2	$ 7	$ 23	$ (88)	$ 245

The elements of deferred income taxes were as follows:

	1997	1996	1995
Tax benefit of losses	$ (5)	$ (36)	$ –
Utilization of prior years' losses	23	–	142
Difference between income tax allowance and accounting amortization of property, plant and equipment	(27)	(9)	–
Expenses deducted for income tax purposes and capitalized in the financial statements	7	1	4
Other	4	–	(11)
	$ 2	$ (44)	$ 135

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

4. INCOME TAXES (CONT'D)

Deferred tax assets and liabilities were as follows:

	1997	1996	1995
Deferred tax assets:			
Non capital loss carryforwards	**$ 76**	$ 99	$ 94
Unclaimed investment tax credit and deferred credits	**34**	40	45
Disallowed reserves	**42**	42	45
Intangible assets	**15**	14	10
	167	195	194
Deferred tax liabilities:			
Difference between income tax and accounting amortization of property, plant and equipment	**(379)**	(405)	(434)
Deferred income taxes	**$ (212)**	$ (210)	$ (240)

The effective income tax rate differs from the Canadian statutory income tax rate. The principal factors causing these different income tax rates were as follows:

	1997	1996	1995
Canadian statutory income tax rate	**40.8 %**	40.9 %	40.4 %
Canadian manufacturing and processing credit	**(4.5)**	(6.5)	(6.7)
Tax on large corporations	**12.9**	(4.0)	1.3
Unrecorded tax effect of U.S. losses	**–**	0.8	–
Realization of unrecorded tax effect of U.S. losses	**–**	–	(0.6)
Tax rate differential resulting from the drawdown of deferred taxes	**(18.4)**	–	2.1
Other	**(5.0)**	(1.6)	–
Effective income tax rate	**25.8 %**	29.6 %	36.5 %

Cash payments for income taxes in 1997 amounted to $8 million (1996 – $8 million; 1995 – $10 million).

5. DISCONTINUED OPERATIONS

Effective April 15, 1996, the Corporation disposed of its Gypsum division and effective June 11, 1996, the Corporation disposed of its Decorative Panels division. After taking into consideration adjustments anticipated in the sales agreements and divestiture costs, net proceeds on these transactions were $604 million.

The net gains relative to these discontinued operations include various provisions for potential obligations established at the time of the divestitures.

The operating results of the above businesses to their effective divestiture dates, together with the net gain on divestitures, were included in "Earnings from discontinued operations" in Consolidated Earnings.

The results of the discontinued operations were as follows:

	1996	1995
Sales	$ 185	$ 589
Operating earnings before income taxes and net of amortization of $8 in 1996 and $32 in 1995	$ 15	$ 75
Income taxes	3	10
Operating earnings from discontinued operations	12	65
Net gain on divestitures, net of income taxes of $16 in 1996	172	–
Earnings from discontinued operations	$ 184	$ 65

6. INVENTORIES

	1997	1996
Operating and maintenance supplies	**$ 67**	$ 65
Raw materials	**90**	101
Work in process and finished goods	**155**	172
	$ 312	$ 338

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

7. PROPERTY, PLANT AND EQUIPMENT

	1997			1996		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Buildings	$ 614	$ 219	$ 395	$ 672	$ 257	$ 415
Machinery and equipment	2,373	880	1,493	2,680	1,190	1,490
Timber limits and land	78	12	66	75	12	63
Assets under construction	–	–	–	14	–	14
	$ 3,065	$ 1,111	$ 1,954	$ 3,441	$ 1,459	$ 1,982

8. OTHER ASSETS

	1997			1996		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Exchange losses on translation of long-term debt	$ 20	$ 3	$ 17	$ 4	$ 2	$ 2
Debt issue expenses	21	5	16	22	6	16
Goodwill and other assets	94	12	82	43	10	33
	$ 135	$ 20	$ 115	$ 69	$ 18	$ 51

9. TRADE AND OTHER PAYABLES

	1997	1996
Trade accounts payable	$ 143	$ 140
Accrued interest	23	23
Accrued vacation pay	29	30
Provision for write-down of assets	–	29
Payables on capital projects	11	33
Other	127	90
	$ 333	$ 345

(in millions of Canadian dollars, unless otherwise noted)

10. LONG-TERM DEBT

	Maturity	1997	1996
Domtar:			
Unsecured debentures and notes			
10.35% Debentures	2006	$ **62**	$ 66
10% Debentures	2011	**82**	82
10.85% Debentures	2017	**75**	75
11 ¾% Notes (1997 and 1996 – U.S.$17)	1999	**24**	23
12% Notes (1997 and 1996 – U.S.$11)	2001	**16**	15
8 ¾% Notes (1997 and 1996 – U.S.$150)	2006	**214**	205
9 ½% Debentures (1997 and 1996 – U.S.$125)	2016	**179**	171
		652	637
Norampac:			
Reducing revolving credit facility (1997 – U.S.$10, FF17, Cdn$47)	2003	**66**	–
Acquisition term facility	1999	**50**	–
Redeemable preferred shares		**100**	–
Other		**6**	–
		222	–
Less: Due within one year		**22**	14
		$ **852**	$ 623

Domtar:
The 10.35% Debentures have sinking fund requirements. The 10% and 10.85% Debentures each have purchase fund requirements, by which the Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, a portion of the aggregate principal amount of the debentures at prices not exceeding par.

Coincident with the contribution of the Packaging net assets to Norampac, amounts available under Domtar's line of credit were reduced from $450 million to $400 million. Borrowings under this bank credit agreement, which matures in January 2001, are secured by receivables and inventories. If sufficient receivables and inventories are not available to provide security for the entire facility, the Corporation may elect to provide additional security in the form of certain property, plant and equipment subject to bank approval. Borrowings secured by property, plant and equipment may not exceed $100 million and will be available to the Corporation when borrowings secured by receivables and inventories are fully utilized.

Borrowings under the $400 million bank credit bear interest at the rate for bankers' acceptances plus 5/8% per annum for Canadian dollar borrowings and at LIBOR plus 5/8% per annum for U.S. dollar borrowings and these margins may increase or decrease depending on Domtar's credit rating in the future. The applicable margins increase by 1/8 of 1% for borrowings supported by property, plant and equipment. There was no Canadian nor U.S. dollar borrowing amount outstanding as at December 31, 1997 and 1996.

As at December 31, 1997, the Corporation had outstanding letters of credit pursuant to this bank credit for an amount of $14 million (1996 – $14 million).

The indentures or agreements for Domtar's borrowings contain restrictive covenants, including a limitation on the amount of dividends on its shares that the Corporation may pay and on the amount of shares that it may repurchase.

Norampac:
Norampac and its subsidiaries entered into a credit agreement with a syndicate of banks with respect to a Reducing Revolving Credit Facility ($175 million), a Revolving Credit Facility ($150 million) and the Acquisition Term Facility ($300 million) (the "Bank Credit"). Borrowings under the Bank Credit are not guaranteed by the Corporation and are secured by the receivables and inventories of Norampac and its subsidiaries (except for the inventory of its French subsidiary) and by the property, plant and equipment of three of its Canadian containerboard mills. The terms of the Bank Credit also include certain financial covenants. Borrowings under the Bank Credit bear interest at base, prime or various money market instrument rates plus a margin determined upon certain ratios attained by Norampac. As at December 31, 1997, the interest rates on outstanding borrowings under the Bank Credit ranged from 5.53% to 6.88%.

The Redeemable Preferred Shares of Norampac are redeemable and retractable at any time at a price of $100 per share, plus all declared and unpaid dividends to the date of redemption. As at December 31, 1997, 2,000,000 Redeemable Preferred Shares were issued and outstanding. On January 7, 1998, Norampac redeemed the Redeemable Preferred Shares, all of which were held by the Corporation. This redemption was financed through borrowings under the Acquisition Term Facility. Since the redemption was financed through long-term borrowings, Domtar has presented its share of the Redeemable Preferred Shares as long-term debt.

As at December 31, 1997, debentures due for retirement, sinking fund provisions or purchase fund requirements in each of the next five years amounted to:

1998	1999	2000	2001	2002
$ 22	$ 32	$ 13	$ 33	$ 29

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

11. OTHER LIABILITIES

	1997	1996
Provision for site rehabilitation costs	$ 28	$ 45
Provision for indemnifications, product warranty and related claims	14	12
Pension liability	20	26
Other	6	8
	$ 68	$ 91

12. COMMITMENTS AND CONTINGENCIES

Environment

Domtar is subject to environmental laws and regulations imposed by federal, provincial (state) and local authorities in Canada and in the United States. In 1997, Domtar made capital expenditures of $5 million (1996 – $52 million, in large part at its pulp mill in Lebel-sur-Quévillon and its fine papers mill in Windsor), in order to comply with air emission regulations in the Province of Québec. The Province of Ontario is currently reviewing its air emission standards. At this time, Domtar cannot estimate the capital expenditures that may be required.

Domtar is continuing to take remedial action under its Care and Control Program at a number of former operating sites, especially in the wood preserving sector, due to possible soil, sediment or groundwater contamination. The process of investigation and rehabilitation is lengthy and subject to the uncertainties of changing legal requirements, developing technological applications, and the allocation of liability among potentially responsible parties.

As at December 31, 1997, Domtar had a $45 million (1996 – $49 million) provision to cover site rehabilitation costs known and determinable, of which $28 million (1996 – $45 million) was included in the "Other liabilities" account. The portion of this provision's fluctuation recognized in earnings in 1997 was a revenue of $1 million in 1997 (1996 – cost of $17 million; 1995 – cost of $9 million) and was included in the "Selling, general and administrative expenses" and "Earnings from discontinued operations" account. However, additional costs, not yet identified, could be incurred for site rehabilitation. Based on policies and procedures in place to monitor environmental exposure, management believes that any additional site rehabilitation costs will not have a material adverse effect on Domtar's financial condition, earnings or liquidity.

Contingencies

Domtar is party to environmental and other claims and lawsuits which are being contested. Management believes that the resolution of these claims and lawsuits will not have a material adverse effect on Domtar's financial condition, earnings or liquidity.

Capital commitments

Domtar has commitments for capital expenditures totalling approximately $10 million as at December 31, 1997.

Lease commitments

Domtar has entered into operating leases for property and equipment. Minimum future rental payments under these operating leases, determined as at December 31, 1997, were as follows:

1998	1999	2000	2001	2002	Thereafter	Total
$ 13	$ 10	$ 8	$ 6	$ 5	$ 20	$ 62

Total rental expense amounted to $18 million in 1997 (1996 – $17 million; and 1995 – $16 million).

13. STATED CAPITAL

Preferred shares

The outstanding preferred shares were as follows as at December 31:

	1997		1996		1995	
	Number of shares	$	Number of shares	$	Number of shares	$
Serial preferred shares						
Series A	69,576	2	69,576	2	69,576	2
Series B	2,310,000	58	2,430,000	61	2,550,000	64
Series C	–	–	–	–	6,000,000	150
Series E	400,000	10	400,000	10	–	–
Series F	1,200,000	30	1,200,000	30	–	–
		100		103		216

(in millions of Canadian dollars, unless otherwise noted)

13. STATED CAPITAL (CONT'D)

The authorized serial preferred shares consist of preferred shares issuable in an unlimited number of series, ranking equal with respect to the payment of dividends and the distribution of assets.

The Series A Preferred Shares are non-voting and redeemable at the Corporation's option at $25.00 per share since April 1, 1994. These shares carry a cumulative cash dividend per share of $2.25 per annum.

The Series B Preferred Shares are non-voting and redeemable at the Corporation's option at $25.00 per share. These shares carry a cumulative cash dividend equivalent to 72% of the bank prime rate.

The Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, 1% of the number of Series A and Series B Preferred Shares outstanding on April 2, 1992 at prices not exceeding $25.00 per share. In connection therewith, Preferred Shares purchased for cancellation were as follows:

	1997		1996	
	Number of shares	**Average price per share**	Number of shares	Average price per share
Series B	**120,000**	**$ 19.06**	120,000	$ 18.57

During 1996, 2,400,000 Series C Preferred Shares were redeemed at $25.00 per share and the remaining balance of 3,600,000 Series C Preferred Shares were converted into 1,200,000 Series D Preferred Shares, 1,200,000 Series E Preferred Shares and 1,200,000 Series F Preferred Shares. All of the Series D Preferred Shares and 800,000 Series E Preferred Shares were redeemed by the Corporation during 1996 at an average price per share of $23.98. The discount on redemption of such shares has been credited to retained earnings.

The Series C Preferred Shares were non-voting and redeemable at the Corporation's option at any time at $25.00 per share or at the holder's option on June 30, 2000, in which case the redemption price may have been, at the option of the Corporation, paid in cash or by the issuance of common shares at a price equal to 87 ½% of the then quoted market value. From June 30, 1995, until redemption in February 1996, these shares carried a cumulative cash dividend, payable quarterly at an annual rate equivalent to 20% of the bank prime rate.

The Series E and F Preferred Shares are non-voting and redeemable at the Corporation's option at any time at $25.00 per share or at the holder's option on April 30, 2001, in which case the redemption price may, at the option of the Corporation, be paid in cash or by the issuance of common shares at a price equal to 87 1/2% of the then quoted market value. The Series E and F Preferred Shares carry a cumulative cash dividend, commencing to accrue on May 2, 1998 and May 1, 1999, respectively, and payable quarterly at an annual rate equivalent to the bank prime rate and increasing to prime plus 2% on May 1, 2000, to prime plus 3% on May 1, 2001 and to prime plus 4% on May 1, 2002.

Common shares

There is no limit on the number of common shares the Corporation is authorized to issue. The changes in the number of outstanding common shares and their aggregate stated value from January 1, 1995 to December 31, 1997 were as follows:

	1997		1996		1995	
	Number of shares	**$**	Number of shares	$	Number of shares	$
Balance at beginning of year	**150,420,907**	**872**	127,801,034	723	127,448,361	719
Shares issued						
– Stock option and share purchase plans	**355,308**	**4**	652,253	5	351,597	4
– Upon conversion of convertible debentures	–	–	23,075,820	150	–	–
– Other	–	–	–	–	1,076	–
Shares purchased for cancellation	**(1,298,400)**	**(8)**	(1,108,200)	(6)	–	–
Balance at end of year	**149,477,815**	**868**	150,420,907	872	127,801,034	723
Book value per common share at end of year		**$ 8.03**		$ 8.04		$ 7.56

In accordance with the terms of the 8% Convertible Unsecured Subordinated Debentures (the "Convertible Debentures"), the Corporation sent a notice of redemption to the holders effective September 19, 1996; as a result, the holders, including Domtar's major shareholders (Société générale de financement du Québec and Caisse de dépôt et placement du Québec), converted prior to that date the Convertible Debentures into 23,075,820 common shares. The Convertible Debentures which had a maturity date of March 18, 2003, were redeemable, subject to certain conditions, at the Corporation's option, at any time, on or after September 18, 1996. These Convertible Debentures were convertible at the option of each holder into common shares, at any time, on or before March 18, 1998, at a conversion price of $6.50 per common share and at a conversion price of $7.25 thereafter.

The interest expense related to the long term debt element of the Convertible Debentures for 1996 and 1995 was charged to income. The interest expense related to the equity element was charged to retained earnings, net of income taxes.

(in millions of Canadian dollars, unless otherwise noted)

13. STATED CAPITAL (CONT'D)

During 1997, the Corporation purchased for cancellation 1,298,400 common shares (1996 – 1,108,200) at an average price per share of $10.55 (1996 – $11.00) under a Normal Course Issuer Bid. The premium paid to acquire the shares over and above the average carrying value has been charged to retained earnings.

Book value per common share is the sum of the stated value of common shares and retained earnings divided by the number of common shares outstanding at year end. In 1995, the calculation of the book value per common share included the accumulated foreign currency translation adjustments.

Earnings per share are calculated using the weighted average number of common shares outstanding during the year, which amounted to 150,401,236 shares in 1997 (1996 – 134,588,228 shares; 1995 – 127,668,789 shares).

Fully diluted earnings per share reflect the most dilutive effect which would have resulted if the Series E and F Preferred Shares had been converted into common shares and if the stock options had been exercised as at January 1, 1997. The number of shares in the calculation of the fully diluted earnings per share was 157,381,486 shares in 1997 (1996 – 157,247,134 shares; 1995 – 170,089,180 shares).

Executive Stock Option and Share Purchase Plan

Under the Executive Stock Option and Share Purchase Plan, (the "Plan"), options, rights and bonus shares may be granted to selected eligible employees. Options expire ten years after the date of the grant. One-fourth of the options may be exercised at each anniversary date of the grant, except for the following: (i) 74% of the options granted in March 1997 will become vested at the rate of 25% per year if the market value of the Corporation's common shares reaches $18.25 after one year, $19.77 after two years, $21.39 after three years and $23.62 after four years, respectively (referred to as the "performance options"); and (ii) 48% of the options granted in March 1996 will become vested at the third anniversary of the grant. After such date, they become wholly exercisable. Options granted during 1997, 1996 and 1995 were at a price equal to the market value on the day immediately preceding the date the options were granted. The fair value of options granted during the year was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: risk-free interest rate of 5.9% (1996 – 7.0%; 1995 – 9.0%); annual dividends of $0.14 in 1997 (1996 – $0.14; 1995 – $0.00); expected lives of 6 years for 1997 (1996 and 1995 – 6 years) and volatility of 31.0% (1996 –30.0%; 1995 – 31.0%).

Changes in the number of options outstanding were as follows:

	1997		1996		1995	
	Number of Options	**Weighted Average Exercise Price**	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding at beginning of year	**1,906,333**	**$ 9.51**	1,452,871	$ 9.07	1,612,446	$ 8.77
Granted	**1,503,614**	**$ 12.29**	970,005	$ 9.63	463,345	$ 10.56
Exercised	**117,080**	**$ 8.61**	275,557	$ 7.23	63,150	$ 11.89
Cancelled	**359,862**	**$ 10.76**	240,986	$ 9.97	559,770	$ 9.11
Outstanding at end of year	**2,933,005**	**$ 10.82**	1,906,333	$ 9.51	1,452,871	$ 9.07
Options exercisable at end of year	**853,672**		542,418		403,377	
Weighted average fair value of options granted during the year		**$ 4.69**		$ 3.75		$ 5.28

The following table summarizes information about stock options outstanding at December 31, 1997:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable**	**Weighted Average Exercise Price**
$ 6.38–$ 9.25	**898,672**	**7.0 years**	**$ 8.45**	**451,547**	**$ 7.80**
$ 9.50–$ 11.00	**609,626**	**7.4 years**	**$ 10.59**	**290,327**	**$ 10.38**
$ 11.25–$ 12.75	**1,330,781**	**9.3 years**	**$ 12.30**	**17,872**	**$ 12.30**
$ 13.00–$ 15.00	**93,926**	**1.4 years**	**$ 13.93**	**93,926**	**$ 13.93**
	2,933,005			**853,672**	

During the year, 116,724 shares were issued pursuant to the exercise of rights and 13,139 bonus shares were issued.

As at December 31, 1997, 5,000,000 common shares (1996 and 1995 – 5,000,000) were authorized for issuance under the Plan.

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

13. STATED CAPITAL (CONT'D)

Employee Share Purchase Plans

Under the plans, employees other than those eligible for the Executive Stock Option and Share Purchase Plan are eligible to purchase common shares at a price of 90% of the market value. Common shares are purchased under the plans on monthly investment dates. Shares purchased under the Canadian plan are subject to a mandatory twelve-month holding period. Employees who hold the shares for 18 months following the date of acquisition (U.S. plan) or who hold the shares purchased in any calendar year until June 30 of the following year (Canadian plan) are entitled to receive additional common shares equivalent to 10% of the cost of such shares. As at December 31, 1997, 2,200,000 common shares (1996 and 1995 – 2,200,000) were authorized for issuance under the plans. During the year, 108,365 common shares (1996 – 132,249; 1995 – 137,167) were issued under the plans at an average price of $10.55 (1996 – $9.55; 1995 – $10.75) per share. Since their inception, 2,136,388 shares were issued under these plans.

14. FINANCIAL INSTRUMENTS

Fair value of financial instruments

	1997		1996	
	Fair Value	**Book Value**	Fair Value	Book Value
Long-term debt	**$ 962**	**$ 874**	$ 692	$ 637

The fair value of the long-term debt, including the portion due within one year, is based on quoted market prices.

Due to their short-term maturity, the carrying values of certain financial instruments were assumed to approximate their fair values. These financial instruments include: cash, receivables, bank indebtedness and trade and other payables. The fair values of the short-term investments are based on quoted market prices of similar short-term investments and approximate their book values. There is no reasonably determinable basis upon which the fair value of financial assets included in investments and advances and of other liabilities can be established.

Interest rate risk

The Corporation's exposure to interest rate risk is as follows:

Cash	Non-interest bearing
Short-term investments	
maturing 1 year or less: $74	Variable interest rate (effective interest rate: 4.5%)
maturing 1 year or less: $200	Non-interest bearing
Receivables	Non-interest bearing
Financial assets included in investments and advances	Floating rate
Bank indebtedness	Non-interest bearing
Revolving bank credit	Floating rate
Trade and other payables	Non-interest bearing
Long-term debt	
maturing 1 year or less: $22	Fixed interest rate
maturing in 2 to 5 years: $107	Fixed interest rate
maturing in 10 or more years: $745	Fixed interest rate

Derivative financial instruments

In order to reduce the potential negative effect of a rising Canadian dollar, the Corporation has entered into various arrangements to hedge anticipated future sales denominated in U.S. dollars.

		Average Rate		Contractual Amounts	
	Type	**1997**	1996	**1997**	1996
		(Canadian dollars)		*(millions of U.S. dollars)*	
Forward foreign exchange contracts					
0 to 12 months	Sell	**$ 1.35**	$ 1.34	**155**	110
13 to 24 months	Sell	**$ 1.34**	$ 1.32	**45**	65
Currency options purchased					
0 to 12 months	Sell	**$ 1.31**	$ 1.35	**335**	490
13 to 24 months	Sell	**$ 1.30**	$ 1.31	**270**	235
25 to 36 months	Sell	**$ 1.32**	$ –	**111**	–
Currency options sold					
0 to 12 months	Sell	**$ 1.36**	$ 1.39	**335**	490
13 to 24 months	Sell	**$ 1.36**	$ 1.36	**285**	235
25 to 36 months	Sell	**$ 1.39**	$ –	**111**	–

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

14. FINANCIAL INSTRUMENTS (CONT'D)

Forward foreign exchange contracts are contracts whereby the Corporation has the obligation to sell U.S. dollars at a specific rate.

Currency options purchased are contracts whereby the Corporation has the right, but not the obligation, to sell U.S. dollars at the strike rate if the U.S. dollar trades below that rate. Currency options sold are contracts whereby the Corporation has the obligation to sell U.S. dollars at the strike rate if the U.S. dollar trades above that rate.

The fair value of derivative financial instruments generally reflects the estimated amounts that the Corporation would receive or pay to settle the contracts at the reporting date. At December 31, the fair value of the above derivative financial instruments was as follows:

	1997	1996
Forward foreign exchange contracts		
Favourable	$ –	$ 1
Unfavourable	(14)	(4)
Currency options		
Favourable (options purchased)	3	10
Unfavourable (options sold)	(46)	(7)

15. ACCUMULATED FOREIGN CURRENCY TRANSLATION ADJUSTMENTS

	1996	1995
Balance at beginning of year	$ (25)	$ (22)
Reduction of the net investment in foreign subsidiaries	25	–
Effect of changes in exchange rates during the year:		
On the net investment in foreign subsidiaries	(1)	(11)
On certain long-term debt denominated in foreign currency designated as a hedge of the net investment in foreign subsidiaries	1	8
Balance at end of year	$ –	$ (25)

For subsidiaries which were considered financially and operationally self-sustaining, the current rate method of translation of foreign currencies was followed. Therefore, all gains and losses arising from the translation of the financial statements of these foreign subsidiaries were deferred in an accumulated foreign currency translation adjustments account.

For long term debt denominated in foreign currency and designated as a hedge of the net investment in foreign subsidiaries, exchange gains and losses were included in the accumulated foreign currency translation adjustments account.

16. INTEREST IN A JOINT VENTURE

Effective December 30, 1997, Domtar and Cascades Inc. merged their respective packaging businesses to form Norampac, a 50-50 joint venture. Domtar's packaging business was contributed to the joint venture for a total consideration of $582 million, of which $100 million was received in cash, $280 million in common shares of Norampac, $200 million in redeemable preferred shares of Norampac (which were totally redeemed for cash on January 7, 1998) and the remainder is to be received as reimbursement of certain capital expenditures.

The total gain (before proportionate consolidation) that resulted from the Norampac transaction amounted to $196 million, of which $98 million, due to Domtar's 50% investment in the joint venture, was not recognized. Of the remaining $98 million, $73 million was deferred and will be amortized over 15 years starting in 1998 and $25 million was realized in 1997 and recorded in Consolidated Earnings. The Consolidated Balance Sheet as at December 31, 1997 includes the following amounts regarding Domtar's share in Norampac's assets and liabilities accounted for by the proportionate consolidation method:

	1997
Assets	
Current assets	$ 119
Long term assets	370
Liabilities	
Current liabilities	$ 88
Long term liabilities	219

The above amounts reflect Norampac management's estimates of fair value as of the date of the acquisition and is based upon available information and certain assumptions that Norampac considers reasonable under the circumstances.

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

17. CASH PROVIDED BY (INVESTED IN) CONTINUING OPERATIONS WORKING CAPITAL

	1997	1996	1995
Change in operating working capital from continuing operations:			
Receivables	$ 4	$ 99	$ (27)
Inventories	26	13	(90)
Prepaid expenses	(4)	5	(5)
Trade and other payables	(12)	(6)	41
Income and other taxes payable	(11)	10	2
	3	121	(79)
Add (deduct):			
Working capital of businesses acquired	–	–	23
Working capital of businesses divested	(7)	(69)	–
Working capital of Packaging division at formation of Norampac	(81)	–	–
Working capital of Norampac at formation	46	–	–
Changes in working capital not affecting cash position	10	(42)	(3)
	$ (29)	$ 10	$ (59)

18. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Domtar has several pension plans covering substantially all employees. These plans are generally contributory in Canada and non-contributory in the United States. In Canada, plan benefits are based primarily on years of service and each employee's highest average eligible earnings during any consecutive 60-month period. On January 1, 1998, a defined contribution option was added to the non-negotiated employees' pension plan where plan benefits are based on the total of employee contributions, Domtar's contributions and investment returns which vary depending on the investment choices made by the employee. In the United States, plan benefits are based on the conversion into an annuity of an amount equal to the accumulation of annual contribution expressed as a percentage of salary. Such percentage is a function of the age of the employee. The assets of the pension plans are invested primarily in listed common stock and fixed income securities.

The pension expense and the obligation for pension benefits are actuarially determined using management's best estimate assumptions. These include: a discount rate of 8.5% (1996 – 8.5%; 1995 – 8.0%) to calculate the present value of the projected benefit obligation; a long-term average annual rate of return of 8.5% (1996 – 8.5%; 1995 – 8.0%) on plan assets; an average annual rate of increase for the unionized employees of 3.0% (1996 – 3.0%; 1995 – 5.0%) and an average annual rate of increase for the non-unionized employees of 3.5% until 2002 (1996 and 1995 – 3.5%) and 5% thereafter in compensation levels unless rate increases have already been committed through labour agreements.

Pension expense

The components of pension expense were as follows:

	1997	1996	1995
Service cost – present value of obligation for pension benefits earned by plan members during the year	$ 8	$ 8	$ 8
Interest cost on projected benefit obligation	43	41	42
Assumed return from investing pension fund assets	(44)	(40)	(38)
Other	(3)	(1)	–
Net pension expense	$ 4	$ 8	$ 12

The actual return generated by investing pension fund assets during 1997 was $77 million (1996 – $81 million; 1995 – $94 million), resulting in an excess of $33 million (1996 – $41 million; 1995 – $56 million) compared to the assumed return. The excess is deferred and amortized in future years, on the basis that the assumed return is the most realistic long-term expectation and that short-term market gains or losses should not distort the pension expense for the year.

(in millions of Canadian dollars, unless otherwise noted)

18. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS (CONT'D)

Funding

Domtar's funding policy is to contribute annually the amount required to provide for benefits earned in the year and to fund past service liabilities over periods not exceeding those permitted by the applicable regulatory authorities. Past service liabilities primarily arise from improvements to plan benefits.

The funded status of the plans was as follows:

	As at December 31, 1997 For plans in which		As at December 31, 1996 For plans in which	
	Assets exceed benefits earned	Benefits earned exceed assets	Assets exceed benefits earned	Benefits earned exceed assets
Plan assets at fair value	$ 460	$ –	$ 574	$ –
Deduct:				
Present value of benefits earned to date based on current compensation levels				
Vested	333	17	428	17
Non-vested	17	1	23	–
Accumulated benefit obligation	350	18	451	17
Present value of future increases in compensation levels	28	3	33	–
Projected benefit obligation	378	21	484	17
Plan assets in excess of (less than) projected benefit obligation	$ 82	$ (21)	$ 90	$ (17)
The above excess (deficiency) is comprised of amounts to be amortized over the expected average remaining service life of plan members and reflected in future earnings, namely:				
Net asset (obligation) as at January 1, 1987, the implementation date of the current accounting policy	$ 2	$ –	$ 4	$ (1)
Prior service cost of retroactive benefits resulting from plan amendments since January 1, 1987	(35)	(2)	(49)	(1)
Net gain (loss) resulting from better (worse) than projected performance	107	(5)	133	(2)
Reduction in obligation due to changes in assumptions	14	1	22	1
	88	(6)	110	(3)
Net pension liability representing pension costs expensed in excess of amounts funded	(6)	(15)	(20)	(14)
	$ 82	$ (21)	$ 90	$ (17)

Other postretirement benefits

Domtar provides group health care and life insurance benefits to certain retirees, their spouses and unmarried dependents. The cost of providing these benefits, which is charged against earnings as incurred, amounted to $4 million in 1997 (1996 – $4 million; 1995 – $6 million).

19. RELATED PARTY TRANSACTIONS

Domtar is not aware of having entered into any transaction other than on normal commercial terms and in the ordinary course of business with either of its major shareholders, Société générale de financement du Québec (directly and indirectly through its wholly-owned subsidiary Dofor Inc.) and Caisse de dépôt et placement du Québec, or any party related thereto.

20. BUSINESS ACQUISITIONS

Effective June 1, 1995, the Corporation acquired all of the issued and outstanding shares of a privately held eastern Canadian distributor of fine papers and industrial products. Effective September 11, 1995, the Corporation acquired the assets of a sawmill located in the Province of Québec. Effective December 4, 1995, the Corporation also acquired the net operating assets of three sawmills located in the Province of

(in millions of Canadian dollars, unless otherwise noted)

20. BUSINESS ACQUISITIONS (CONT'D)

Québec. The total consideration for these acquisitions was $88 million. These acquisitions have been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets and liabilities based on their estimated fair value as of the acquisition dates. The excess of the purchase price over the fair value of the net assets acquired has been recorded as goodwill and is being amortized on a straight-line basis over periods not exceeding twenty-five years. The results of operations related to these acquisitions have been included in these consolidated financial statements from the effective dates of acquisition. Details of the acquisitions are as follows:

	1995
Net assets acquired at assigned values:	
Assets acquired	
Working capital	$ 23
Fixed assets	57
Goodwill	18
Liabilities assumed	
Long-term debt	(10)
	$ 88
Consideration:	
Cash	$ 69
Payables	19
	$ 88

21. SEGMENTED INFORMATION

The operations and assets of Domtar by industry segment and by geographic area were as follows:

	1997	1996	1995
By industry segment			
Sales			
Fine papers	$ 1,052	$ 1,061	$ 1,240
Pulp and forest products	408	426	359
Packaging	478	490	607
	$ 1,938	$ 1,977	$ 2,206
Operating profit (loss) (A)			
Fine papers	$ 94	$ 82	$ 279
Pulp and forest products	7	22	112
Packaging	(45)	5	118
	56	109	509
Unusual item (B)	–	35	–
	$ 56	$ 74	$ 509
Identifiable assets (C)			
Fine papers	$ 1,329	$ 1,396	$ 1,399
Pulp and forest products	761	726	493
Packaging	489	434	384
	2,579	2,556	2,276
Assets under construction	–	14	107
Corporate	383	114	382
Discontinued operations	–	25	426
	$ 2,962	$ 2,709	$ 3,191
Amortization			
Fine papers	$ 85	$ 83	$ 76
Pulp and forest products	35	42	21
Packaging	24	18	17
	$ 144	$ 143	$ 114
Additions to property, plant and equipment			
Fine papers	$ 44	$ 78	$ 113
Pulp and forest products	52	164	163
Packaging	34	94	62
	130	336	338
Corporate	2	13	2
Discontinued operations	–	6	39
	$ 132	$ 355	$ 379

	1997	1996	1995
By geographic area			
Sales			
Canada			
Within Canada	$ 944	$ 994	$ 1,169
To United States	926	916	957
Offshore	50	59	72
	1,920	1,969	2,198
United States	18	8	8
	$ 1,938	$ 1,977	$ 2,206
Operating profit (A)			
Canada	$ 48	$ 104	$ 501
United States	8	5	8
	56	109	509
Unusual item	–	35	–
	$ 56	$ 74	$ 509
Identifiable assets (C)			
Canada	$ 2,396	$ 2,482	$ 2,292
United States	156	88	91
Offshore	27	–	–
	2,579	2,570	2,383
Corporate	383	114	382
Discontinued operations	–	25	426
	$ 2,962	$ 2,709	$ 3,191

(A) Operating profit represents sales, reflecting transfer prices at market value, less allocable expenses before financing expenses and income taxes.

(B) The operating profit by industry segment for 1996 after unusual item was as follows:

	1996
Fine papers	$ 47
Pulp and forest products	22
Packaging	5
	$ 74

December 31, 1997

(in millions of Canadian dollars, unless otherwise noted)

21. SEGMENTED INFORMATION (CONT'D)

(C) Identifiable assets are those which are directly used in segment operations or geographic areas. Corporate assets are principally cash, short-term investments, certain non-trade receivables, prepaid expenses, property, plant and equipment and other assets.

22. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The financial statements have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP) which, in the case of Domtar, conform in all material respects with GAAP in the United States (U.S. GAAP), except as set forth below.

(a) Earnings and balance sheet adjustments

Earnings adjustments

	1997	1996	1995
Net earnings in accordance with Canadian GAAP	$ 25	$ 97	$ 304
Pension cost (1)	(23)	(10)	4
Unrealized exchange gain (loss) on translation of long-term debt (2)	(17)	41	36
Unrealized loss on forward exchange contracts (3)	(11)	(3)	–
Postretirement benefit cost other than pensions (5)	(3)	(3)	4
Gain on contribution to Norampac (1) (5) (9)	76	–	–
Increase in gain on divestitures caused by the settlement of the pension and postretirement benefit obligations (1) (5)	–	29	–
Premium and write-off on early redemption of long-term debt (6)	–	94	–
Interest on equity element of convertible debentures (7)	–	(4)	(5)
Income tax impact of the above adjustments	(8)	(38)	(16)
Difference in the determination of income taxes (8)	12	–	–
Net earnings before extraordinary items	51	203	327
Extraordinary items (6)	–	(64)	–
Net earnings in accordance with U.S. GAAP	51	139	327
Dividend requirements of preferred shares	2	3	5
Net earnings applicable to common shares in accordance with U.S. GAAP	$ 49	$ 136	$ 322
Per common share in accordance with U.S. GAAP			
Basic			
Net earnings before extraordinary items	$ 0.32	$ 1.49	$ 2.53
Extraordinary items	–	(0.48)	–
Net earnings in accordance with U.S. GAAP	$ 0.32	$ 1.01	$ 2.53
Diluted			
Net earnings before extraordinary items	$ *	$ 1.32	$ 1.96
Extraordinary items	–	(0.40)	–
Net earnings in accordance with U.S. GAAP	$ *	$ 0.92	$ 1.96

** No dilution or antidilutive*

Balance sheet adjustments

	1997		1996	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
Other assets (1) (2) (9)	$ 115	$ 118	$ 51	$ 88
Trade and other payables (1) (3) (4) (9)	333	348	345	343
Deferred credits (9)	116	43	57	57
Deferred income taxes (8) (9)	212	154	210	157
Other liabilities (1) (5) (9)	68	122	91	144
Shareholders' equity (1) to (9)	1,301	1,366	1,312	1,351

(1) The determination of the net pension cost in accordance with U.S. GAAP differs with respect to the valuation of plan assets at January 1, 1987 and the basis used to determine the expected return on plan assets.

(2) Unrealized exchange gains and losses arising on the translation, at exchange rates prevailing on the balance sheet date, of long-term debt repayable in a foreign currency are deferred and amortized over the remaining life of the related debt. Under U.S. GAAP, such exchange gains and losses are included in earnings.

(in millions of Canadian dollars, unless otherwise noted)

22. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT'D)

(3) Gains and losses arising on forward exchange contracts are included in earnings only at maturity. Under U.S. GAAP, unrealized gains and losses are included in earnings as recognized.

(4) Under Canadian GAAP, the cost of providing postemployment benefits can either be charged against earnings and funded in the year incurred or provided for on an accrual basis. As allowed by Canadian GAAP, Domtar is accounting for postemployment benefits on a cash basis. Under U.S. GAAP, postemployment benefit costs are charged against earnings on an accrual basis rather than on a cash basis.

(5) Under Canadian GAAP, the cost of providing postretirement benefits other than pensions can either be charged against earnings and funded in the year incurred or provided for on an accrual basis. As allowed by Canadian GAAP, Domtar is accounting for postretirement benefits other than pensions on a cash basis. Under U.S. GAAP, postretirement benefit costs other than pensions are charged against earnings on an accrual basis rather than on a cash basis.

(6) Under Canadian GAAP, losses realized on the early redemption of long-term debt are included in earnings. Under U.S. GAAP, these items are specifically classified as extraordinary items.

(7) Under Canadian GAAP, the interest expense related to the equity element of the convertible debentures net of income taxes is charged to retained earnings. Under U.S. GAAP, the interest expense related to the principal amount of the convertible debentures is charged to earnings.

(8) Under Canadian GAAP, income taxes are provided on the deferral method basis whereas under U.S. GAAP, income taxes are provided on the liability method basis.

(9) As required by Canadian GAAP, the Corporation accounts for its investment in Norampac by the proportionate consolidation method (Note 16). Under U.S. GAAP, this investment would be accounted for by the equity method. This difference does not impact the reported earnings or shareholders' equity except for the gain on contribution to Norampac.

(b) Supplementary disclosures

i) Postretirement benefits other than pensions

The components of postretirement benefit cost were as follows:

	1997	1996	1995
Service cost for the year	**$ 1**	$ 1	$ 1
Interest cost on accumulated postretirement benefit obligation	**6**	6	8
Net amortization	**–**	(1)	(7)
Net postretirement benefit cost	**$ 7**	$ 6	$ 2

The following table sets forth the funded status of the plans reconciled to the accrued postretirement benefit cost:

	1997	1996	1995
Accumulated postretirement benefit obligation:			
Retirees	**$ 54**	$ 51	$ 74
Fully eligible active plan participants	**5**	14	22
Other active plan participants	**19**	6	8
	78	71	104
Net gain to be amortized	**4**	8	7
Accrued postretirement benefit cost	**$ 74**	$ 79	$ 111

For measurement purposes, an 11.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 1997 (1996 – 11.0%;1995 – 0.0%); the rate was assumed to be 10.0% in 1998 and to decrease gradually to 6.0% in 2006 (1996 and 1995 – 6.0%) and to remain at that level thereafter. A 1.0% increase in this annual trend rate would have increased the accumulated postretirement benefit obligation as at December 31, 1997 by approximately $4 million (1996 – $5 million; 1995 – $7 million) and would not have increased the net postretirement benefit cost for the year ended December 31, 1997 (1996 – no increase; 1995 – increase of $1 million).

The Corporation uses average compensation growth and discount rate assumptions to estimate its accumulated postretirement benefit obligation. These rates were 5.0% and 6.5%, respectively, as at December 31, 1997 and 5.0% and 8.0%, respectively, as at December 31, 1996.

ii) Accounting for stock-based compensation

Under U.S. GAAP, the Corporation has elected to continue to measure compensation cost related to awards of stock options using the intrinsic value based method of accounting. In this instance, however, under FASB Statement 123, the Corporation is required to make pro forma disclosures of net earnings, basic earnings per share and diluted earnings per share as if the fair value based method of accounting had been applied. Accordingly, the Corporation's net earnings, basic earnings per share and diluted earnings per share for the year ended December 31, 1997 would have been reduced, on a pro forma basis, by $2 million, $0.01 and $0.01 (1996 – $1 million, $0.01 and $0.01), respectively. The pro forma effect on net earnings for the years ended December 31, 1997 and 1996 is not representative of the pro forma effect on net earnings in future years because it does not take into consideration pro forma compensation expense related to stock

(in millions of Canadian dollars, unless otherwise noted)

22. UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT'D)

options awarded prior to 1995. Pro forma disclosures for the year ended December 31, 1995 have not been presented because they are not considered relevant.

iii) Consolidated cash flows
Under U.S. GAAP, the statement of cash flows would reconcile the opening balance of cash and cash equivalents to the amount of cash and cash equivalents at the end of the year, without regard to bank indebtedness and short-term investments not constituting cash equivalents. Consequently, under U.S. GAAP, the variation in bank indebtedness and in short-term investments not constituting cash equivalents would be disclosed as a financing activity. Such amounts are $15 million, $(12) million and $10 million for the years ended December 31, 1997, 1996 and 1995, respectively.

Under U.S. GAAP, investing and financing activities of an enterprise that do not result in cash receipts or cash payments are reported in the notes to the financial statements and not in the statement of cash flows. Consequently, under U.S. GAAP, the issuance of common shares and the conversion of convertible debentures would both be reduced by $150 million, representing the conversion of convertible debentures during the year ended December 31, 1996.

Under U.S. GAAP, the net cash flow from discontinued operations would be classified as an investing activity rather than as an operating activity, as it is under Canadian GAAP.

Under U.S. GAAP, dividend payments must be classified as a financing activity.

iv) Consolidated comprehensive income

	1997	1996	1995
Net earnings in accordance with U.S. GAAP	$ 51	$ 139	$ 327
Foreign currency translation adjustments	–	25	(3)
Consolidated comprehensive income	$ 51	$ 164	$ 324

v) Impact of accounting pronouncements not yet implemented

Accounting for income taxes
In 1997, the Canadian Institute of Chartered Accountants ("CICA") has issued a new accounting standard concerning accounting for income taxes. Domtar is required to adopt this standard for Canadian GAAP reporting purposes for the fiscal year beginning with 2000. Earlier adoption of this standard is optional. Domtar has not yet determined when it will adopt this standard. Had the standard been implemented on January 1, 1997, it is estimated that shareholders' equity would have increased by approximately $62 million at December 31, 1997, with a corresponding decrease in deferred income taxes.

Reporting segment disclosures
In 1997, the CICA has issued a new accounting standard concerning reporting segmented disclosures. Concurrently, FASB Statement 131 was issued in the United States. Both statements require increased disclosures about operating segments. Domtar is required to adopt both statements for the fiscal year beginning with 1998. Management has not yet determined the impact of the application of these standards.

SUPPLEMENTARY INFORMATION

December 31, 1997

Selected Production Statistics

(in thousands of tonnes, unless otherwise noted)	1997	1996	1995	1994	1993
Fine papers (in thousands of tons)	780	766	752	764	737
NBSK pulp	242	239	239	254	224
Lumber (in millions of board feet)	613	736	488	463	371
Containerboard	601	563	580	574	534
Corrugated containers (in millions of square metres, double-faced equivalent)	587	547	541	549	512

Quarterly Financial Information (unaudited)

(in millions of Canadian dollars, except per share amounts)	1st	2nd	3rd	4th	Year
1997					
Sales	$ 447	$ 482	493	$ 516	$ 1,938
Operating profit (loss)	(6)	–	21	41	56
Gain on contribution to Norampac	–	–	–	25	25
Net earnings (loss)	(12)	(10)	5	42	25
Net cash flow from operations	(86)	53	31	110	108
Net consideration received upon contribution to Norampac	–	–	–	285	285
Additions to property, plant and equipment	28	30	26	48	132
EBITDA before non-recurring items	30	35	57	78	200
Per common share					
Net earnings (loss)					
Basic	(0.09)	(0.07)	0.03	0.27	0.15
Fully diluted	*	*	*	0.26	*
1996					
Sales	$ 499	$ 493	$ 510	$ 475	$ 1,977
Operating profit before unusual item	58	23	28	–	109
Operating profit (loss)	58	(12)	28	–	74
Premium and write-off on early redemption of long-term debt	6	121	–	–	127
Earnings (loss) from continuing operations	12	(103)	8	(4)	(87)
Net earnings (loss)	21	72	8	(4)	97
Net cash flow from continuing operations	14	79	31	58	182
Net proceeds from business divestitures	–	604	–	–	604
Additions to property, plant and equipment	82	81	75	117	355
EBITDA before non-recurring items	94	59	64	35	252
Per common share					
Earnings (loss) from continuing operations					
Basic	0.07	(0.82)	0.05	(0.03)	(0.69)
Fully diluted	*	*	*	*	*
Net earnings (loss)					
Basic	0.14	0.55	0.05	(0.03)	0.68
Fully diluted	0.13	0.45	*	*	0.63

* *no dilution or antidilutive*

December 31, 1997
(in millions of Canadian dollars, except per share amounts)

Selected Financial Data

	1997	1996	1995	1994	1993
Canadian GAAP					
Sales	**$ 1,938**	$ 1,977	$ 2,206	$ 1,596	$ 1,287
Operating profit (loss) before unusual items	**56**	109	509	127	(37)
Operating profit (loss)	**56**	74	509	154	(37)
Gain on contribution to Norampac	**25**	–	–	–	–
Earnings (loss) from continuing operations	**25**	(87)	239	11	(106)
Net earnings (loss)	**25**	97	304	78	(110)
Total assets	**2,962**	2,709	3,191	2,847	2,691
Long-term debt	**852**	623	1,082	1,220	1,204
Total liabilities	**1,661**	1,397	1,913	1,869	1,787
Shareholders' equity	**1,301**	1,312	1,278	978	904
Per common share					
Earnings (loss) from continuing operations					
Basic *(1)*	**0.15**	(0.69)	1.80	0.02	(0.88)
Fully diluted	*	*	1.41	*	*
Net earnings (loss)					
Basic *(1)*	**0.15**	0.68	2.32	0.55	(0.91)
Fully diluted	*	0.63	1.80	0.46	*

The selected financial data presented above is prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP). In the case of Domtar, these differ in certain respects from accounting principles generally accepted in the United States (United States GAAP), as shown in the reconciliation presented in note 22 to the consolidated financial statements on page 53. Earnings and balance sheet data based on United States GAAP follow.

	1997	1996	1995	1994	1993
United States GAAP					
Earnings (loss) from continuing operations	**$ 51**	$ (9)	$ 264	$ (20)	$ (135)
Net earnings (loss) before cumulative effect of accounting changes and extraordinary items	**51**	203	327	46	(140)
Net earnings (loss)	**51**	139	327	44	(156)
Total assets	**2,965**	2,746	3,181	2,796	2,666
Long-term debt	**852**	623	1,185	1,318	1,298
Total liabilities	**1,599**	1,398	2,007	1,946	1,862
Shareholders' equity	**1,366**	1,351	1,174	850	804
Per common share					
Earnings (loss) from continuing operations					
Basic *(1)*	**0.32**	(0.09)	2.03	(0.18)	(1.09)
Diluted	*	*	1.58	*	*
Net earnings (loss) before cumulative effect of accounting changes and extraordinary items					
Basic *(1)*	**0.32**	1.49	2.53	0.34	(1.12)
Diluted	*	1.32	1.96	0.29	*
Net earnings (loss)					
Basic *(1)*	**0.32**	1.01	2.53	0.32	(1.25)
Diluted	*	0.92	1.96	0.28	*

(1) The 1997 results include the after-tax impact of the gain on contribution to Norampac of $0.11 per share. The 1996 and 1994 results include the after-tax impact of unusual items of $(0.17) and $0.11 per share, respectively.

* *no dilution or antidilutive*

HISTORICAL SUMMARY

(in millions of Canadian dollars, except per share amounts and statistical data)

			1997	1996	1995
Operations	Sales		$ 1,938	$ 1,977	$ 2,206
	Operating expenses		1,882	1,868	1,697
	Operating profit (loss) before unusual items		56	109	509
	Unusual items and other expenses	Unusual items	–	35	–
		Financing expenses	50	72	123
		Premium and write-off on early redemption of long-term debt	–	127	–
		Gain on contribution to Norampac	(25)	–	–
		Income tax expense (recovery)	8	(37)	141
		Non-controlling interest	(2)	(1)	6
	Earnings (loss) from continuing operations		25	(87)	239
	Discontinued operations, net of income taxes		–	184	65
	Net earnings (loss)		$ 25	$ 97	$ 304
Financial position	Assets	Cash and short-term investments and deposits	$ 283	$ 44	$ 286
		Other current assets	567	593	710
		Property, plant and equipment	1,954	1,982	2,076
		Other assets	158	90	119
		Total assets	$ 2,962	$ 2,709	$ 3,191
	Liabilities and shareholders' equity	Short-term financing	$ –	$ –	$ –
		Other current liabilities	408	408	416
		Long-term debt	852	623	1,082
		Deferred credits and non-controlling interest	121	65	78
		Deferred income taxes	212	210	240
		Other liabilities	68	91	97
		Equity element of convertible debentures	–	–	99
		Preferred shares	100	103	216
		Common shareholders' equity	1,201	1,209	963
		Total liabilities and shareholders' equity	$ 2,962	$ 2,709	$ 3,191
Cash flows	Operations	Net cash provided by (used for) operating activities	$ 108	$ 172	$ 526
	Investments	Additions to property, plant and equipment	(132)	(355)	(379)
		Acquisition of businesses	–	–	(88)
		Net consideration received upon contribution to Norampac	285	–	–
		Net proceeds from business divestitures	–	604	–
		Other	3	(15)	245
	Financing	Long-term debt and equity financing	–	510	4
		Change in revolving bank credit	–	–	(89)
		Change in short-term financing	–	–	–
		Redemption, repayments and other	(17)	(1,129)	(31)
	Dividend payments		(23)	(17)	(5)
	Increase (decrease) in net cash position		$ 224	$ (230)	$ 183
Other data	Per common share	Earnings (loss) from continuing operations *(1)*	$ 0.15	$ (0.69)	$ 1.80
		Net earnings (loss) *(1)*	$ 0.15	$ 0.68	$ 2.32
		Cash dividends declared	$ 0.14	$ 0.14	$ –
		Year-end book value	$ 8.03	$ 8.04	$ 7.56
		Market price			
		Toronto and Montréal stock exchanges			
		High	$ 13.50	$ 12.70	$ 14.75
		Low	$ 8.85	$ 9.00	$ 9.25
	Ratios	Return on common shareholders' equity	2%	9%	37%
		Debt-to-total-capitalization ratio *(2)*	33:67	32:68	40:60
	Other statistics	Number of common shareholders	7,254	8,732	9,347
		Number of preferred shareholders	418	485	555
		Common shares outstanding (millions)	149.5	150.4	127.8
		Number of employees *(3)*	7,300	7,574	9,503
		Salaries, wages and benefits *(3)*	$ 461	$ 462	$ 550

(1) *The 1997 results include the after-tax impact of the gain on contribution to Norampac of $0.11 per share. The 1996, 1994, 1992, 1990 and 1989 results include the after-tax impact of unusual items of $(0.17), $0.11, $(0.11), $(1.84) and $(0.16) per share, respectively.*

(2) *Ratio of debt, including retractable preferred shares for the years 1987 to 1991, net of cash, of short-term investments and of short-term deposits held in trust, to total capitalization.*

1994	1993	1992	1991	1990	1989	1988	1987
$ 1,596	$ 1,287	$ 1,270	$ 1,238	$ 1,630	$ 1,741	$ 1,657	$ 1,514
1,469	1,324	1,344	1,309	1,625	1,628	1,524	1,377
127	(37)	(74)	(71)	5	113	133	137
(27)	–	19	–	252	22	–	–
133	133	107	84	96	72	33	13
–	–	–	–	–	–	–	–
–	–	–	–	–	–	–	–
10	(64)	(77)	(53)	(133)	(5)	32	51
–	–	–	–	–	1	1	–
11	(106)	(123)	(102)	(210)	23	67	73
67	(4)	(36)	(46)	(84)	10	44	88
$ 78	$ (110)	$ (159)	$ (148)	$ (294)	$ 33	$ 111	$ 161
$ 319	$ 115	$ 42	$ 115	$ 2	$ 35	$ 44	$ 105
575	548	557	517	616	798	727	685
1,809	1,898	1,955	2,038	2,115	2,263	2,207	1,943
144	130	116	72	91	183	208	180
$ 2,847	$ 2,691	$ 2,670	$ 2,742	$ 2,824	$ 3,279	$ 3,186	$ 2,913
$ –	$ –	$ –	$ –	$ 69	$ 238	$ 108	$ –
367	338	465	308	378	409	400	429
1,220	1,204	976	1,246	1,051	869	879	793
79	95	103	112	123	138	158	157
99	66	118	209	277	408	413	361
104	84	79	68	67	27	17	14
93	88	–	–	–	–	–	–
219	222	225	81	81	82	84	84
666	594	704	718	778	1,108	1,127	1,075
$ 2,847	$ 2,691	$ 2,670	$ 2,742	$ 2,824	$ 3,279	$ 3,186	$ 2,913
$ 179	$ 19	$ (86)	$ (22)	$ 68	$ 205	$ 199	$ 292
(243)	(107)	(76)	(93)	(200)	(322)	(407)	(511)
–	–	–	–	(6)	(73)	(24)	(256)
–	–	–	–	–	–	–	–
297	28	–	8	158	97	15	–
(231)	3	13	8	10	(2)	(22)	(13)
3	365	350	99	118	33	157	435
(21)	(25)	(194)	219	16	65	–	–
–	–	–	(69)	(104)	65	106	–
(16)	(195)	(86)	(15)	(24)	(41)	(11)	(57)
(3)	(3)	(7)	(12)	(39)	(56)	(56)	(55)
$ (35)	$ 85	$ (86)	$ 123	$ (3)	$ (29)	$ (43)	$ (165)
$ 0.02	$ (0.88)	$ (1.06)	$ (1.20)	$ (2.46)	$ 0.13	$ 0.61	$ 0.67
$ 0.55	$ (0.91)	$ (1.36)	$ (1.69)	$ (3.44)	$ 0.23	$ 1.12	$ 1.69
$ –	$ –	$ –	$ –	$ 0.3049	$ 0.4878	$ 0.4878	$ 0.4878
$ 5.23	$ 4.69	$ 5.57	$ 7.12	$ 8.94	$ 12.78	$ 13.07	$ 12.49
$ 10.125	$ 9.25	$ 8.375	$ 10.00	$ 13.50	$ 18.00	$ 16.50	$ 25.75
$ 6.50	$ 4.875	$ 4.25	$ 7.00	$ 9.00	$ 12.875	$ 12.00	$ 11.50
12%	(17)%	(23)%	(21)%	(33)%	2%	9%	14%
49:51	55:45	54:46	59:41	57:43	49:51	45:55	39:61
10,303	10,868	11,284	11,673	12,434	13,791	14,578	14,730
624	704	806	2,021	2,322	2,615	2,945	3,144
127.4	127.1	126.2	100.9	87.0	86.7	86.3	86.1
8,985	9,821	10,270	11,145	13,280	15,819	16,053	15,871
$ 551	$ 562	$ 564	$ 585	$ 667	$ 723	$ 702	$ 653

(3) The 1997 data includes 100% of Domtar's packaging division, although it was contributed to Norampac on December 30, 1997.

Companies listed with the Montréal and Toronto stock exchanges have to disclose, on an annual basis, their approach to corporate governance and conformity of their practices with the *Guidelines for Improved Corporate Governance* ("Guidelines") issued by the stock exchanges. These guidelines deal, among other things, with the responsibilities of directors, the constitution of the board and board committees, and board practices.

Domtar's corporate governance principles and practices have been developed by the Corporate Governance Committee and adopted by the Board of Directors in keeping with the Guidelines and with similar systems introduced by public companies.

MANDATE OF THE BOARD

According to the *Canada Business Corporations Act*, the Corporation's governing statute, the business and affairs of the Corporation are managed under the supervision of its Board of Directors. There is no specific mandate for the Board since it has plenary power. The Board determines, among others, the management philosophy, assesses management's execution and reviews the results obtained. Its duties include approval of strategic plans, review of corporate risks identified by management and of the Corporation's practices and policies for dealing with these risks, management succession planning, and assessment of the integrity of the Corporation's internal controls and information systems.

COMPOSITION OF THE BOARD

The Board of Directors is of the view that its directors are unrelated directors, except for Mr. Gilles Blondeau who controls a company that has received the mandate to manage part of the bond portfolio of the Corporation's pension funds; Mr. Claude Fontaine who is a partner of a law firm which provides legal services to the Corporation on a regular basis; Mr. Harry E. Gould whose company is an important customer of the Corporation; Mr. Raymond Royer, President and Chief Executive Officer of the Corporation; and Mr. Edward J. Waters who is associated with a financial institution which, from time to time, has provided financial services to the Corporation.

Domtar does not have a "significant shareholder" as defined in the Guidelines to mean a shareholder with the ability to exercise a majority of the votes for the election of the Board of Directors. At the 1997 Annual Shareholders' Meeting, sixteen (16) directors were elected to the Board of Directors; the names of five (5) of these directors were proposed for election by each of Société générale de financement du Québec ("SGF") and Caisse de dépôt et placement du Québec ("Caisse") which held 24.31% and 22% of the Corporation's common shares, respectively. Domtar has been informed by SGF and Caisse that they presently intend to vote their shares so that their nominees represent a majority of the Board of Directors.

The Board includes a number of directors who do not have interests in or relationships with either the Corporation, SGF or Caisse, and the Board is of the opinion that its composition represents fairly the investment in the Corporation by shareholders other than SGF and Caisse.

BOARD CHAIRMAN SEPARATE FROM MANAGEMENT

The positions of Chairman of the Board and Chief Executive Officer are separate and distinct. Mr. Jacques Girard holds the position of Chairman of the Board since August 1996. Mr. Raymond Royer holds the position of President and Chief Executive Officer since September 1996.

At all meetings of the Board and Committees of the Board, the opportunity is provided for any outside Board member to request that members of management be excused so that any matter may be discussed without any representative of management being present. During 1997, the Board held two *in camera* sessions without any representatives of management being present.

COMMITTEES

The Board has established the following committees:

The Executive Committee is composed of six (6) directors, three (3) of whom are outside unrelated directors, one (1) is an outside related director, one (1) is an inside related director and one (1) is an inside unrelated director. Except as otherwise provided by law and by the administrative resolutions of the Corporation, this Committee may exercise all the powers of the Board of Directors. In practice, however, the Committee acts only with respect to specific matters delegated to it by the Board of Directors and its approval level is limited to investments not exceeding $10 million. The Committee met three times in 1997.

The Corporate Governance Committee is composed of three (3) directors, all of whom are outside unrelated directors. The mandate of the Committee is to:

- develop and monitor the system of corporate governance of the Corporation; and
- advise the Board of Directors and the committees of the Board on corporate governance and on conformity of the Corporation's practices with the corporate governance guidelines issued by the stock exchanges.

The Corporate Governance Committee met twice in 1997.

The Nominating Committee is composed of five (5) directors, two (2) of whom are outside unrelated directors, two (2) are outside related directors and one (1) is an inside unrelated director. The mandate of the Committee is to:

- recommend annually to the Board members proposed for re-election to the Board and recommend the names of candidates suitable for election to the Board;
- review and evaluate periodically the performance and contribution of all directors and the effectiveness of the Board as a whole;
- review annually the compensation of the directors in their capacity as directors, and make recommendations to the Board;
- review periodically the mandates and performance of the committees of the Board and review annually the memberships and chairs of the committees and make recommendations to the Board.

The Committee met four times in 1997.

The Human Resources Committee is composed of five (5) directors, three (3) of whom are outside unrelated directors, one (1) is an outside related director and one (1) is an inside unrelated director. The mandate of the Committee is to:

- review the human resources policies of the Corporation;
- approve the engagement and termination, and the promotion and compensation of the members of the Management Committee of the Corporation and the engagement of all officers of the Corporation, except for the Chief Executive Officer and the Chief Operating Officer of the Corporation in respect of whom the Committee makes recommendations to the Board; and
- review annually, or as needed, the succession planning for the Chief Executive Officer and the Chief Operating Officer, the senior management of the Corporation and their direct reports.

The Committee met six times in 1997.

The Audit Committee is composed of four (4) members, three (3) of whom are outside unrelated directors and one (1) is an outside related director. The mandate of the Committee is to:

- review, prior to submission to the Board, all financial information and financial statements of the Corporation and the external auditors' report thereon;
- review with the external and internal auditors of the Corporation the arrangements for and scope of each proposed audit of the accounting records and report to the Board any significant reservations the Committee may have or the external or internal auditors may have expressed with respect to such arrangements or scope;
- review periodically with the Corporation's external and internal auditors their respective activities and the nature of their respective recommendations and to report on same at least annually to the Board;
- evaluate the performance of the external auditors, review their fees and make recommendations to the Board in this respect;
- evaluate annually the organization, independence and efficiency of the internal auditors; and
- review periodically the code of ethics of the Corporation and its adherence by management.

The Committee met four times in 1997.

The Pension Committee is composed of five (5) directors, two (2) of whom are outside unrelated directors, one (1) is an inside related director, one (1) is an inside unrelated director and one (1) is an outside related director. The mandate of the Committee is to:

- approve the investment policy of the pension funds and the benchmarks used to measure the performance of the pension funds;
- recommend annually to the Board, for its approval, the funding policy for the pension funds;
- approve the hiring of the external portfolio managers and their objectives, and evaluate the performance of the external and internal portfolio managers;
- approve assumptions used in actuarial valuations of the pension funds and review reports thereon; and
- recommend to the Board, for its approval, amendments to the pension plans.

The Committee met four times in 1997.

The Environment and Health and Safety Committee is composed of five (5) directors, three (3) of whom are outside unrelated directors, one (1) is an inside related director and one (1) is an outside related director. The mandate of the Committee is to review the policy, management plans, programs, practices and performance of the Corporation in light of applicable environment and health and safety legislative requirements, assess the performance of the Corporation in these areas and make recommendations to the Board.

The Committee met three (3) times in 1997.

DECISIONS REQUIRING PRIOR APPROVAL BY THE BOARD

In general, all matters of management philosophy and strategic direction, and all actions proposed to be taken by the Corporation which are not in the ordinary course of its operations require prior approval of the Board or of a Board committee to which approval authority has been delegated by the Board.

RECRUITING NEW DIRECTORS AND ASSESSMENT OF BOARD PERFORMANCE

The Nominating Committee is responsible for presenting Board candidates to the entire Board of Directors for its consideration. The Committee is also responsible for reviewing and evaluating the performance and contribution of all Directors and the effectiveness of the Board as a whole, in accordance with the criteria established in consultation with the Corporate Governance Committee.

SHAREHOLDER COMMUNICATIONS

The Corporation communicates regularly with its shareholders and the investment community through quarterly reports, annual reports and press releases. The Corporation has a shareholder relations process and an investor relations and communication program which enable the Corporation to respond adequately to shareholder questions and concerns and to communicate effectively with its shareholders, stakeholders and the public in general.

BOARD'S EXPECTATIONS OF MANAGEMENT

The Board can and does act independently of management. The Board expects management to be responsible for the operation of the business, while respecting authorized financial limits, and adhering to the strategic plan, operational budget and approved corporate policies of the Corporation. The Board expects to be advised by management, on a regular basis, as to the results being achieved, and to be presented with alternative plans and strategies to be implemented for approval, in keeping with evolving conditions.

BOARD OF DIRECTORS

as at January 31, 1998

Jacques Girard 1, 3, 4, 6
Montréal
Chairman of the Board,
Domtar Inc.,
President and
Chief Executive Officer
Montréal International

Claude Blanchet 1, 3
Montréal
Chairman of the Board,
President and
Chief Executive Officer
Société générale de financement du Québec

Gilles Blondeau 1, 3, 4
Montréal
Chairman of the Board and
Chief Executive Officer,
Groupe Optimum Inc.

Paul-Henri Couture 3, 7
Montréal
Vice-President,
Capital d'Amérique CDPQ inc.

Claude Fontaine, Q.C. 2
Montréal
Partner in the law firm
Ogilvy Renault

Louis P. Gignac 1, 3, 5
Montréal
President and
Chief Executive Officer,
Cambior Inc.

Harry E. Gould Jr. 5
New York
Chairman, President and
Chief Executive Officer,
Gould Paper Corporation

Claude R. Lamoureux 1, 4, 6
Toronto
President and
Chief Executive Officer,
Ontario Teachers'
Pension Plan Board

Pierre Lamy 2, 4, 5
Montréal
Economic and
Financial Consultant

Jacques Laurent 5, 7
Montréal
Partner in the law firm
Guy & Gilbert

Brian M. Levitt 7
Montréal
President and
Chief Executive Officer
Imasco Limited

Louiselle Paquin 2
Montréal
Vice-President Finance,
Information Systems,
Risk Management and Insurance
SITQ inc.

Louise Roy
Montréal
President and
Chief Executive Officer,
Télémédia inc.

Raymond Royer 1, 5, 6
Montréal
President and
Chief Executive Officer,
Domtar Inc.

John D. Thompson 2, 6
Montréal
Deputy Chairman of the Board,
Montréal Trustco Inc.

Edward J. Waters 4, 6
New York
Financial Consultant

Members of the:
1 Executive Committee
2 Audit Committee
3 Human Resources Committee
4 Nominating Committee
5 Environment and Health and Safety Committee
6 Pension Committee
7 Corporate Governance Committee

MANAGEMENT

as at January 31, 1998

Raymond Royer *
President and
Chief Executive Officer

Guy L. Boucher
Vice-President, Environment

Yvon Boyer
Vice-President, St. Catharines
Fine Papers

Jeff Butler
Vice-President, Forest Products

Denis Couture
Vice-President,
Communications and
Government Relations

Daniel Denault *
Vice-President, Finance

Ghislain Dinel
Vice-President, Windsor
Fine Papers

Christian Dubé *
Vice-President,
Corporate Development

Ed Farley
Vice-President, Sales, Marketing,
Customer Service & Logistics
Fine Papers

Roland Gagnon *
Vice-President,
Human Resources Development
and Work Organization

Jocelyn Gilbert
Vice-President,
Sales – Forest Products

Robert J. Eamer *
Senior Vice-President,
Technology Development

Y. Glen Katsuyama
Vice-President, Legal Services

George Kobrynsky *
Senior Vice-President,
Fine Papers

Normand Lecours *
Senior Vice-President,
Kraft Pulp and Forest Products

Barry Lynch *
Vice-President and General
Manager, Merchants

Gilles Pharand *
Senior Vice-President,
Corporate Affairs,
General Counsel and Secretary

Myrianne Robillard
Controller

A.J. (Eddie) Ross
Senior Vice-President,
Forestry Activities

Régis Savard
Vice-President,
Operations – Norkraft
Kraft Pulp and Forest Products

Dave Stott
Vice-President,
Sales & Marketing – Pulp
Kraft Pulp and Forest Products

Razvan L. Theodoru
Assistant Secretary

Pierre Trudel
Vice-President, Cornwall
Fine Papers

Nicholas Willis
Assistant Treasurer

** Member of the Management Committee*

GLOSSARY

Alkaline process
A paper-making process which produces papers that are brighter and longer-lasting – up to 500 years, compared with 50 years for conventional acidic papers. Alkaline papers are also stronger, enabling a portion of fibre content to be replaced with filler, thus conserving fibre resources. In addition, the alkaline process requires less energy.

Containerboard
A type of paperboard used for packaging applications.

Corrugated containers
Containers formed from corrugated board, which most commonly features a fluted layer of corrugated medium in between two flat liners.

Corrugated medium
A sheet of containerboard that is formed into «flutes» or ridges to provide added strength, shock-cushioning and insulation properties.

Cut-size paper
Reprographic paper such as that used in photocopiers or laser printers that is packaged in sheets of various sizes rather than on rolls.

ISO
International Standards Organization, based in Geneva.

Linerboard
Containerboard lining the interior and exterior surfaces of corrugated containers.

NBSK
Northern Bleached Softwood Kraft Pulp, a very high-quality type of wood pulp, the raw material used to manufacture paper.

OCC
Old corrugated containers.

Process close-up/closed loop
Advanced process-control technology which virtually eliminates any discharge of contaminated effluents.

Stumpage fees
Fees levied on the value of timber cut on government-owned land.

Tonne
Metric tonne (1 metric tonne = 1.1023 short tons).

This annual report was lithographed on the following papers:

Cover:
Cornwall Coated Cover, coated two sides,
10 pt – 149 lb – 242g/m²

CRYSTAL PULP 20%

Inside pages (first section):
Plainfield Plus, Britewhite, Smooth Finish,
80 lb – 160 (M) – 118 g/m²

CRYSTAL PULP 20%

Inside pages (Financial Review):
Sandpiper, Mist, Smooth Finish,
70 lb – 140 (M) –

100% recycled paper, all post-consumer fiber

100% NON-DEINKED PULP

lily of the valley, mushroom, oat, bluebell, mint, apple, blossom and fern only

Cornwall Coated Cover, Plainfield Plus and Sandpiper papers are manufactured by Domtar Fine Papers Division. Vegetable inks were used in the production of the Domtar Inc. 1997 Annual Report.

Production:
Communications and Government Relations Department, Domtar Inc.

Graphic Design:
Desjardins Design Marketing

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Rosemont, Illinois — tel.: (847) 698-9700, fax: (847) 698-9708

Covington, Kentucky — tel.: (606) 292-2088, fax: (606) 292-2087

Costa Mesa, California — tel.: (714) 751-5531, fax: (714) 751-7320

Marietta, Georgia — tel.: (770) 565-6024, fax: (770) 565-7993

Dallas, Texas — tel.: (214) 665-9407, fax: (214) 665-9408

Issaquah, Washington — tel.: (425) 557-4317, fax: (425) 557-4318

Minneapolis, Minnessota — tel.: (612) 525-2292, fax: (612) 595-9699

DOMTAR MERCHANTS

The Paper House

Dartmouth, Nova Scotia — tel.: (902) 468-6323, fax: (902) 468-4311

Mount Pearl, Newfoundland — tel.: (709) 368-2108, fax: (709) 368-1018

Saint John, New Brunswick — tel.: (506) 633-0909, fax: (506) 653-9802

Buntin Reid Paper

Mississauga, Ontario — tel.: (905) 670-6060, fax: (905) 670-6064

Ottawa, Ontario — tel.: (613) 731-8410, fax: (613) 731-8013

London, Ontario — tel.: (519) 659-8446, fax: (519) 659-8449

JBR La Maison du Papier

Lachine, Québec — tel.: (514) 636-5006, fax: (514) 636-7135, toll free: 1 888 671-5000

Québec City, Québec — tel.: (418) 623-2800, fax: (418) 627-0350

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PACKAGING

NORAMPAC Inc.

Montréal, Québec — tel.: (514) 282-2635, fax: (514) 282-2677

DOMTAR'S PLANTS & SALES OFFICES – STRATEGICALLY LOCATED TO SERVE MARKETS

SHAREHOLDER AND INVESTOR INFORMATION

Annual Meeting
The Annual Meeting of Shareholders will be held at 10:30 a.m. on Thursday, April 23, 1998, in The Queen Elizabeth Hotel, Montréal, Québec.

Annual Information Form
The Annual Information Form may be obtained by writing to the Secretary of Domtar Inc.

Transfer Agents and Registrars
For Common and Series "A" and "B" Preferred Shares and Debentures:
Montreal Trust Company – Halifax, N.S.; Saint John, N.B.; Montréal, Qué.; Toronto, Ont.; Winnipeg, Man.; Regina, Sask.; Calgary, Alta.; Vancouver, B.C.

For Common Shares only:
The Bank of New York, New York, N.Y.

U.S. Cash Dividend Plan
Shareholders wishing to receive dividends in U.S. dollars may obtain detailed information by communicating with Montreal Trust Company at (514) 982-7555 or 1-800-736-1755.

Stock Exchanges
Common and Series "A" and "B" Preferred Shares are listed on Montréal, Toronto and Vancouver stock exchanges.

The Common Shares are also listed on the New York Stock Exchange.

Ticker Symbol: DTC

Investor Relations
Christian Dubé
Vice-President, Corporate Development
Telephone: (514) 848-5511
Internet: IR@email.domtar.com

Shareholder Services
Shareholders having inquiries concerning their shares or debentures, or wishing to obtain information about the Corporation should contact:

Montreal Trust Company
Shareholder Services
1800 McGill College Avenue
Place Montréal Trust
6th Floor
Montréal, Québec
H3A 3K9
Telephone: (514) 982-7555 or 1-800-736-1755

Head Office
395 de Maisonneuve Blvd. West
Montréal, Québec
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